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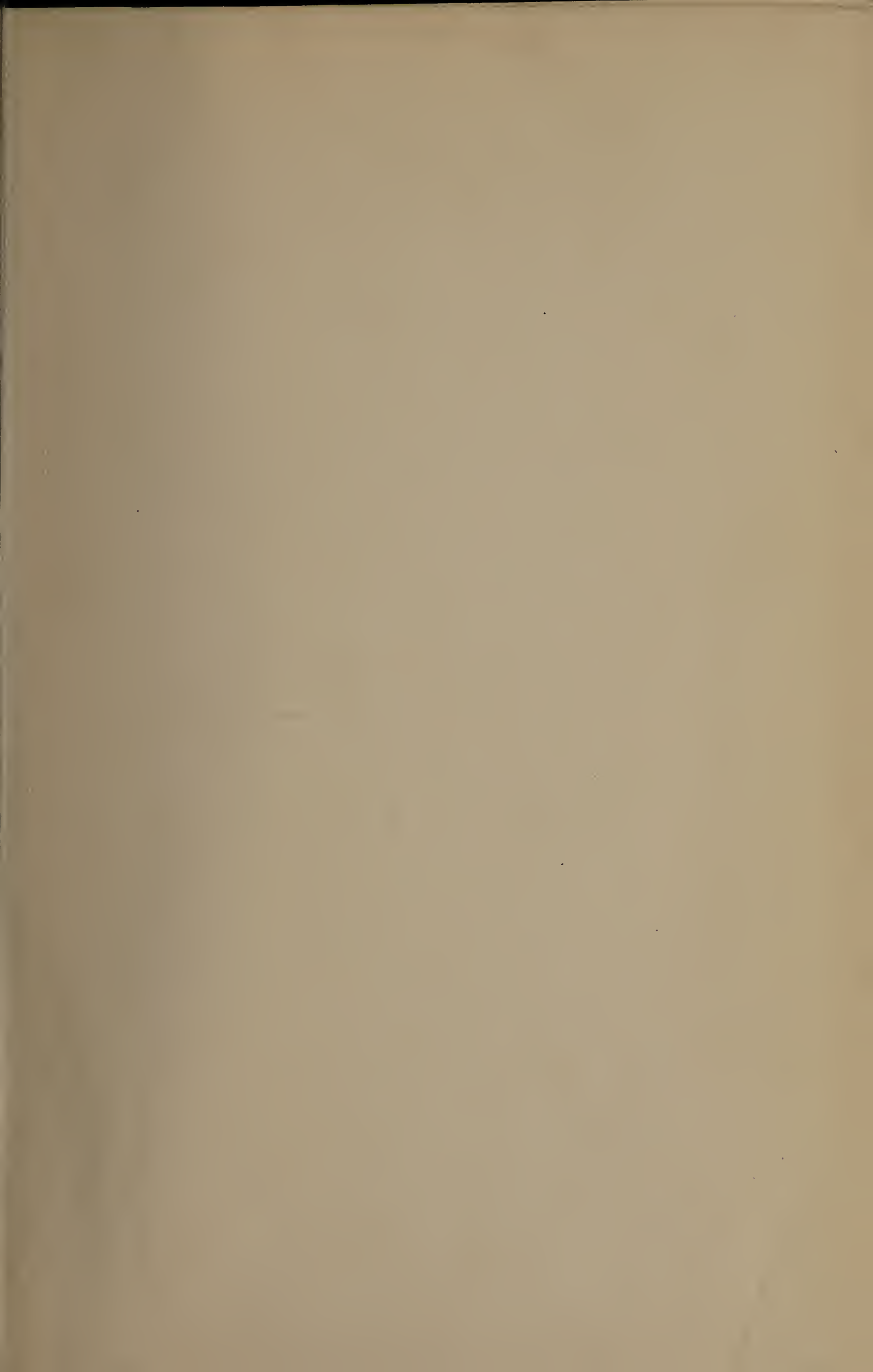
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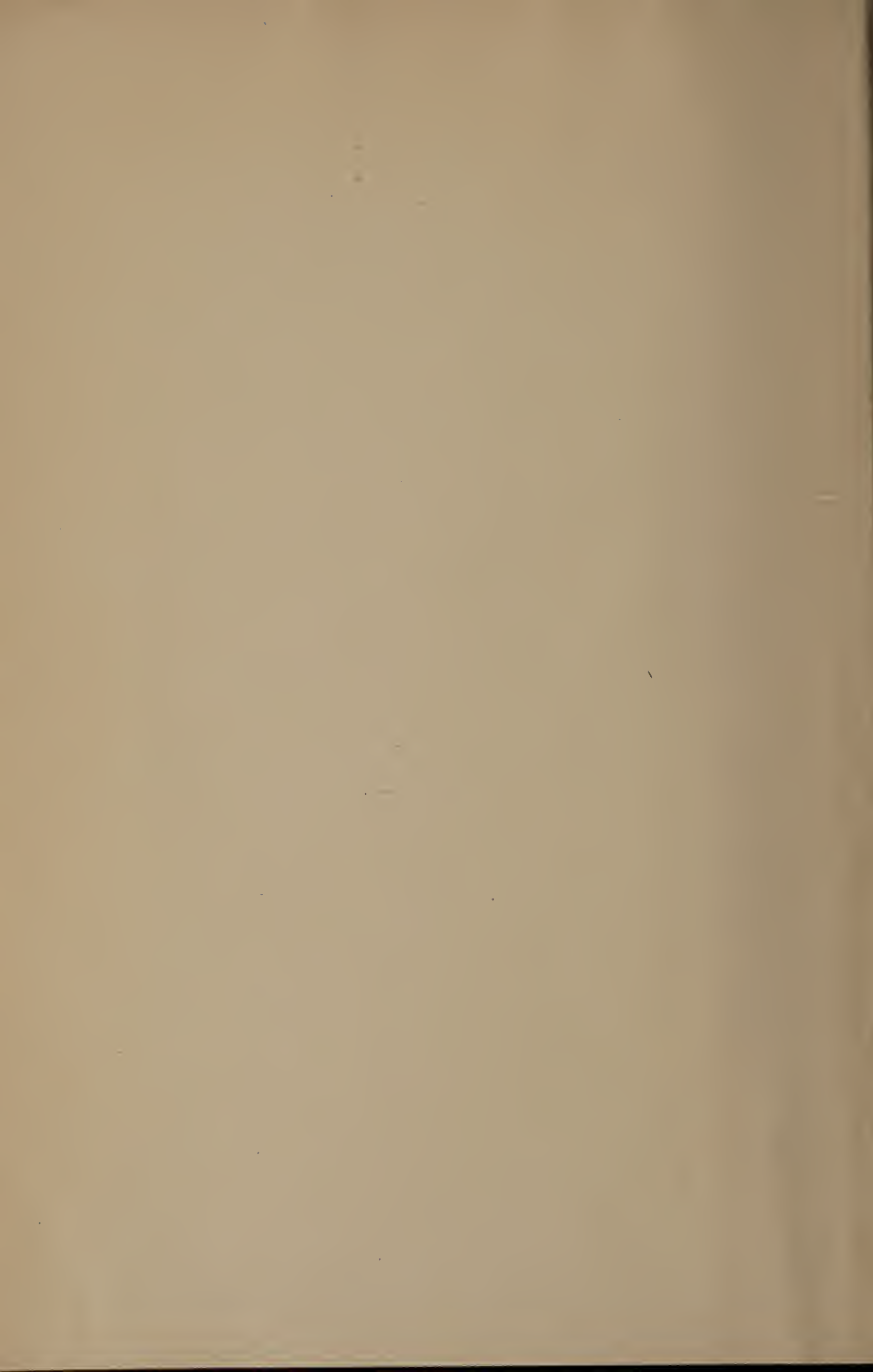
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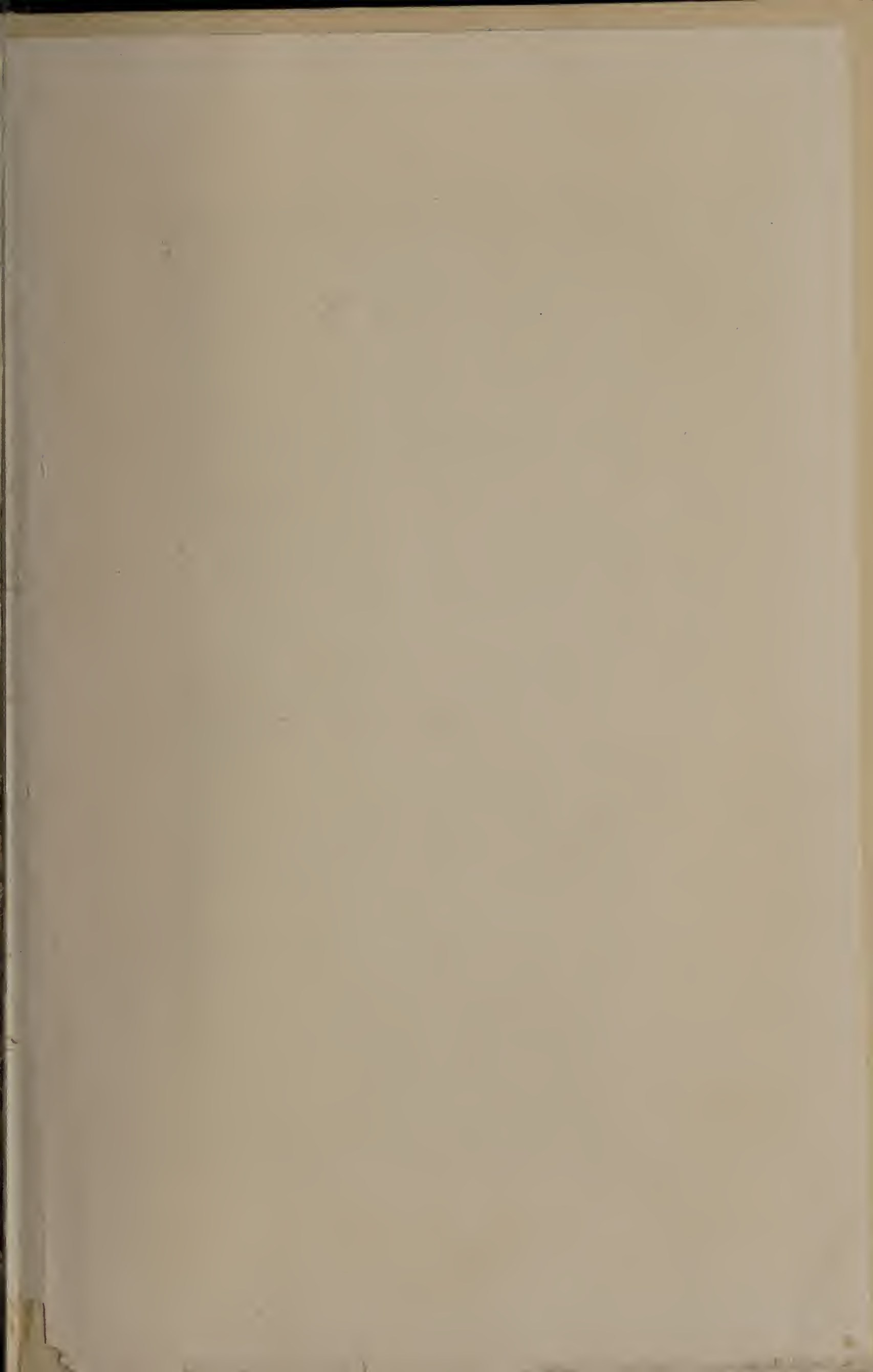
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The Original Dale Creek Bridge
Furnished by Passenger Department of the Union Pacific System

HISTORY
OF THE
UNION PACIFIC
A Financial and Economic Survey

By
NELSON TROTTMAN
Of the Wisconsin Bar



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PREFACE

The railroad situation today constitutes a problem of far greater moment than ever before. Permanent business prosperity cannot exist unless we have a healthy and permanent solution of the railroad problem. The story of the Union Pacific shows the vitality of a rightly located railroad, and its power, under competent management, of working free from the handicaps of financial exploitation, and becoming a source of profit to its stockholders and of service to the entire community.

The Union Pacific together with its western connection, the Central Pacific, was the first and for many years the only trans-continental railroad. The sixty years of its existence saw the opening up of the western half of the country, and in this vast development the Union Pacific bore a chief part. In later years, as a Harriman road, the Union Pacific has been identified with perhaps the greatest of American railway operators. Yet though the road has often been in the limelight, its dramatic story has never been assembled in its entirety. The present work gives a general account of the Union Pacific Railroad from its birth during the Civil War, in 1862, to the annual report of the directors for the fiscal year ending December 31, 1921, after the return of the railroads to private control following the World War.

Many important lessons are to be learned from the successive stages of Union Pacific history: the launching of the road with fervid but hasty enthusiasm and in a peculiar degree with national backing; the profligacy and chicanery of old-time railroad management, by which resources and good will were alike thrown away; the collapse and receivership; the speedy revival and expansion in the hands of a competent management; the final stage of close governmental supervision

of private initiative culminating in the Railroad Administration and the Esch-Cummins Law of 1920.

The peculiar relations long subsisting between the United States government and the Union Pacific bring out the bungling, bureaucratic processes of government and the great dangers of uninformed public opinion, often demanding legislation the effect of which is to punish the men of today for the misdeeds of the former generation and, in the process, imposing a heavy handicap on legitimate business development.

The personal testimony of the early promoters, of the Credit Mobilier people, of Jay Gould, Russell Sage, and other speculators of the past generation, and in more recent times of E. A. Harriman, Otto H. Kahn, and their associates, is voluminous and readily accessible among the government publications. There exists also a mass of documentary evidence in the shape of reports, court records, and similar data. This abundant source material makes it possible to present the full financial and economic history of this great railroad company, the character of its relations with the federal government, and the account of the process by which the Union Pacific expanded from a single stretch of main line a thousand miles in length to the great system which the road controls and operates today.

NELSON TROTTMAN.

Milwaukee, Wisconsin,

August 25, 1923.

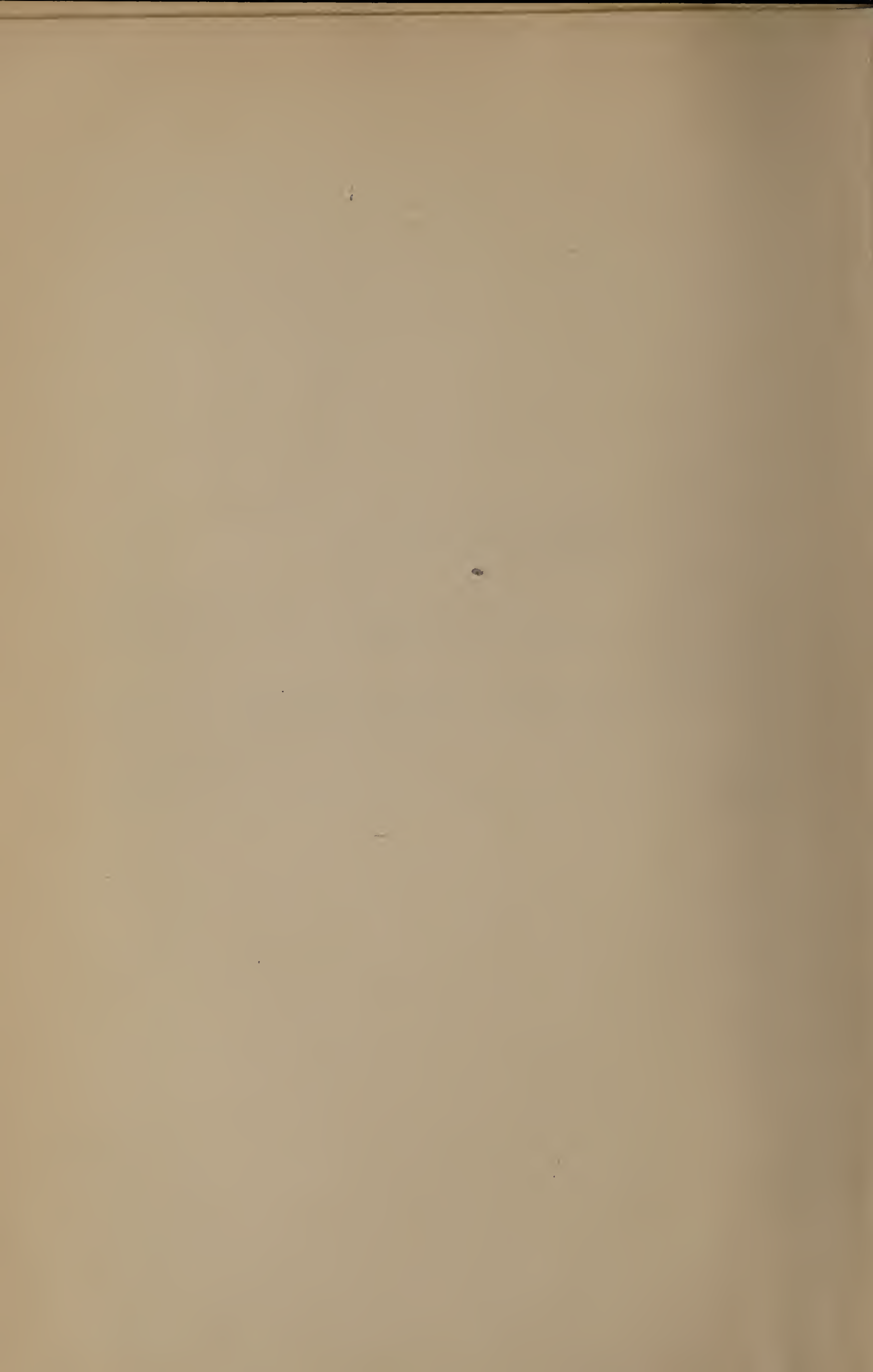
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HISTORY
OF THE
UNION PACIFIC



CHAPTER I

THE PACIFIC RAILROAD ACTS

Isolation of the Pacific Slope

Soon after the United States, in 1848, added to its possessions vast tracts of territory in the far west and on the Pacific Coast, the construction of a Pacific railroad became one of the absorbing problems of the day. There was general apprehension that failure on the part of this nation to build a transcontinental railroad might eventually mean the loss of California. The isolated settlements of California were separated from the Mississippi Valley by a stretch of mountain and desert land nearly 2,000 miles wide, and the ease with which a foreign power might successfully invade the state was one, but not the only, danger which menaced American possession. The bonds which, during the fifties, held California to the Union were largely sentimental. Its people were American by birth and in sympathies but, being separated from "The States" by hundreds of miles of uninhabited and mountainous territory, were to all intents and purposes independent of the central authority. The difficulties and dangers of western transportation were great, and these difficulties and dangers were experienced in full measure by the national government when, in 1857, it attempted to enforce the federal laws against Mormonism in Utah. The overland route to California consumed more time and was thought far more hazardous than the long voyage by way of Panama or around Cape Horn. California's senators and representatives usually made the journey to Washington by way of the Isthmus of Panama. The trip consumed from $4\frac{1}{2}$ to 5 weeks. In the days of the "forty-niners" it had required a whole summer, from early in May until September, to travel overland in a "prairie

schooner" to California. In 1858, the establishment of a regular stage line shortened the time, so that the trip from the Missouri River to California could thereafter be made in about one month.¹ But hostile Indians and the perils of starvation and thirst in what was then known as the "Great American Desert" made this trip overland dangerous, as well as long, difficult, and expensive.

On the discovery of gold in 1848 men swarmed into California. In two years, by 1850, with a population of over 100,000, it was admitted into the Union. The necessity for solving the problem of far western transportation was still further increased by the growth of sporadic settlements in Colorado and the development of mining in the Pike's Peak region in the late fifties. During the same decade Nevada's great silver mines began to attract prospectors; but all western development was retarded by the lack of adequate transportation facilities. As western mining camps grew in number the "commerce of the prairies" increased in importance, and the government established and maintained army posts at heavy expense for the protection of the overland trade routes of the western plains against Indian attacks. Fort Leavenworth, Fort Kearney, Fort Riley, Fort Laramie, Fort Bridger, are a few of the better-known posts. But the protection which these posts afforded to western travel was by no means adequate. They were few in number, the distances between the several posts were great, and the transportation of troops and supplies was slow and very costly.

Early Railroad Surveys

Early in the decade from 1850 to 1860 several lines of railroad had been built uniting the important cities of the east with the middle west. These lines were at first made up of comparatively small independent connecting roads, and would not now be considered through lines. The first of

¹ F. L. Paxson, *The Last American Frontier*, New York, 1910, pp. 178, 180.

these lines forming a connecting system between New York and Chicago was opened in 1853,² and lines were building westward into Missouri and the "Granger" country of Illinois, Wisconsin, and Iowa. The first suggestion of building a railroad to the Pacific seems to have been made as early as 1832,³ at a time when railroad building and operation were still in the experimental stage. The Oregon boundary question was settled with Great Britain in 1846, and California was ceded to the United States in 1848, and toward the close of the forties men were beginning to urge upon the public the feasibility and necessity of building a Pacific railroad. The most prominent of these early enthusiasts was Asa Whitney, a New York merchant of large means who as early as 1840 foresaw the great future of the railroad, and how great would be its influence in the development of civilization. He believed a Pacific railroad would become an important thoroughfare for Oriental trade as well as a great domestic commercial highway, and conducted a vigorous campaign for its construction. To this end he devoted his time and his fortune. During the forties and early fifties he published many articles and kept up a constant agitation; he memorialized Congress session after session to take some action toward the construction of a Pacific railroad; and he conducted some surveys in the west at his own expense.⁴ Whitney spent his declining years in Washington in obscurity and comparative poverty, but he lived to see the fulfilment of his hopes when, on May 10, 1869, the last spike was driven in the first transcontinental railroad.

In 1853 Congress appropriated \$150,000 to make explorations and surveys "to ascertain the most practicable and economical route for a railroad from the Missouri River to the Pacific Ocean."⁵ The following surveys were made; the

² F. L. Paxson, *Early Railroads in the Northwest*, in the *Transactions of the Wisconsin Academy of Sciences*, Vol. XVII, Pt. I.

³ The "Emigrant," a weekly paper published at Ann Arbor, Michigan Territory, No. 12, Vol. III, Feb. 6, 1832.

⁴ J. P. Davis, *The Union Pacific Railway*, Chicago, 1894, Ch. II.

⁵ 10 Stat. L. 219.

northernmost, along the forty-fifth parallel; the next, along the forty-second parallel; and farther south, one along the thirty-seventh parallel, one along the thirty-fifth parallel; and the southernmost along the thirty-second parallel.⁶ These surveys correspond roughly with the present routes of the Northern Pacific, the Union Pacific, the Missouri Pacific-Denver and Rio Grande, the Santa Fé, and the Southern Pacific roads. The true value of these surveys was the proof they offered that the building of a Pacific railroad was not a visionary, but a practical, project. During the fifties the Pacific railroad question was the subject of many debates in Congress; numerous Pacific railroad mass meetings, at which the building of the road was strongly advocated, were held throughout the country; state legislatures adopted resolutions urging its construction; and had it not been for sectional differences between the north and south, the work would probably have been undertaken before the Civil War.

The Pacific Railroad in Politics

By the year 1855 the general sentiment throughout the nation favored the building of a railroad to the Pacific.⁷ There were, however, two principal causes which delayed the undertaking: one, the difficulty of financing the project; the other, conflicting sectional interests. The Pacific railroad was to be a national undertaking for the benefit of the whole country; but constitutional scruples and questions of expediency stood in the way of a government-built and operated road. Private capital could not be expected to undertake a project involving such great financial risk as building a Pacific railroad without receiving in some form governmental aid. The national government had been following a policy of making large grants of land to railroad companies in order to foster the construc-

⁶ The reports of these surveys have been published in eleven large volumes. Sen. Exec. Docs. No. 78, 33rd Cong., 2nd sess. (serial Nos. 758-768 inclusive). An additional volume has been published as House Exec. Docs. No. 56, 30th Cong., 1st sess. (serial No. 1054).

⁷ Paxson, *The Last American Frontier*, pp. 192, 211.

tion of new roads. A land grant would not offer sufficient inducement to capital to bring about the building of a Pacific railroad, as public opinion of that period believed that the entire region west of the Missouri River was a barren desert.⁸ It was, moreover, well understood that whatever route might be adopted, a Pacific railroad would pass through a mountainous region, and popular belief greatly exaggerated the expense and the engineering difficulties involved in building a road over the Rocky Mountains. A liberal subsidy would have to be provided in addition to a land grant in order to induce private capital to undertake the work.

In either event, whether the road was to be government-built and owned or government-aided, congressional action was necessary; but to secure this prerequisite there was need of a greater degree of harmony among the members of the national legislature than obtained during the stormy decade just before the Civil War. The south wanted a southern route. It was partly with the idea of securing a route for a southern Pacific railroad that the Gadsden purchase was made, in 1853.⁹ The north wanted a northern or a central route. Neither section would yield to the other. During the fifties there were proposed in Congress a number of bills which aimed at harmonizing sectional differences and at reaching an agreement which would permit the road's construction. The most comprehensive of these compromise suggestions was that made in 1855 by Senator Stephen A. Douglas, who proposed a Pacific railroad bill which provided for a northern, a central, and a southern road, each to be constructed under federal aid in the form of a land grant and a bonus of government bonds. Senator Douglas' bill apparently satisfied the southern senators, for it passed the Senate on February 19, 1855;¹⁰ but it was not satisfactory to the north, and so it failed to pass the lower

⁸ *Ibid.*, p. 11.

⁹ James Schouler, *History of the United States of America*, New York, 1904, Vol., V, p. 293.

¹⁰ *Cong. Globe*, 33rd Cong., 2nd sess., p. 314.

house. Thus sectional differences effectually prevented congressional action.

The Republican platform of 1856 declared in favor of granting federal aid for the construction of a Pacific railroad.¹¹ So did the Republican platform of 1860.¹² In that year the Democratic party was divided into a northern and a southern wing; but both wings of that party were agreed on the advisability of granting aid to encourage private capital to build the road.¹³ While neither the north nor the south would yield to the other regarding the route, the whole country desired a Pacific railroad, and was willing to grant liberal aid to any group of private capitalists who would build it. Aside from the benefits to be derived in aiding the future development and settlement of the west, a railroad to the Pacific was a military necessity. Questions of expediency forced to the background the old doubts of strict constructionists regarding the constitutionality of granting federal aid toward internal improvements. There was even some talk of having the government itself build and operate the road, and a fairly large element of the country's population appears to have favored the idea;¹⁴ but questions of expediency as well as constitutional scruples prevented the serious consideration of any plan looking to the construction and operation of a government-owned road. The preponderating sentiment of the nation at that time was apparently in favor of entrusting the work of constructing a Pacific railroad to private capital, aided by liberal subsidies.

Instead of hindering or indefinitely postponing the Pacific railroad, the Civil War gave to the project the impetus which ultimately carried it through to completion. Secession removed the chief obstacle to the passage of a Pacific railroad bill, for

¹¹ T. H. McKee, *National Conventions and Platforms of all Political Parties, 1789 to 1900*, Baltimore, 1900 (3rd ed.), p. 99.

¹² *Ibid.*, p. 108.

¹³ *Ibid.*, p. 111.

¹⁴ On this point see Gen. G. M. Dodge, *How We Built the Union Pacific Railway*, published as Sen. Doc. 447, 61st Cong., 2nd sess. (serial No. 5658), p. 11. Also, speech of Rep. J. Morrill, *Cong. Globe*, 37th Cong., 2nd sess., p. 1947. See generally, the debates in Congress at this period.

the southern senators and representatives, who had refused to vote for any bill to aid a road unless it were to run south of the thirty-seventh parallel, were no longer members of Congress. Soon after the war broke out a delicate international situation gave rise to the gravest alarm lest California should be lost. In 1861 occurred the famous Mason and Slidell incident, which brought this nation very near to a war with England. The north feared that in case such a war were to break out, the seizure of our possessions on the Pacific by England could not be prevented. It was reported in the House of Representatives that the British Pacific fleet had received orders to seize California in the event of a war between Great Britain and the United States.¹⁵ Fortunately this threatened war was averted, but the fear of a possible attack upon California remained notwithstanding the settlement of the Mason and Slidell affair. The Pacific slope, including California with its great mineral wealth, lay practically defenseless against foreign aggression. Without quick and safe transportation facilities it would be difficult to hold this territory against a foreign enemy in the event of war. The pages of the Congressional Globe are convincing evidence that, in the popular mind, the military feature of the proposed Pacific Railroad was the paramount consideration in 1861 and 1862. Such a railroad was a national military necessity, required by the defenselessness of the Pacific Coast, by Indian disturbances which compelled the government to police the plains at an enormous expense for the transportation of troops and supplies, and by the widely felt need of binding the Union together more firmly.¹⁶ The commercial and economic importance of the road was at that time a secondary consideration.¹⁷

¹⁵ Speech of Rep. Sargent, Cong. Globe, 37th Cong., 1st sess., p. 1595.

¹⁶ It seems to have been for this reason that the road was named the "Union Pacific."

¹⁷ For a complete discussion of the history of the passage of the Pacific Railroad Act, see Davis, *The Union Pacific Railway*, pp. 19-135; also White, *The History of the Union Pacific Railway*, Chicago, 1895, pp. 1-16; Paxson, *The Last American Frontier*, Chs. XII, XIII; and the Pacific Railroad debates in the Cong. Globe, 37th Cong., 2nd sess.

The Act of 1862

Such was the general situation, when in June, 1862, Congress passed the first Pacific Railroad Act. The motive that inspired its liberal grants of land and credit is indicated by its title, which reads: "An Act to aid in the Construction of a Railroad and Telegraph Line from the Missouri River to the Pacific Ocean, and to secure to the Government the Use of the same for Postal, Military and Other Purposes."¹⁸

The conflicting local interests of different northern communities influenced the form in which the bill was finally passed. St. Louis wished to be on the main line; so did Chicago, Sioux City, Atchison, and other Missouri River and middle west towns. To fix the western terminus at San Francisco or Sacramento was a simple matter; but it was difficult to agree upon the eastern terminus. Apparently for the purpose of placating rival local communities, the act, instead of concentrating national effort on one line, provided for the construction of a four-pronged system. The act chartered a corporation, which was to be known as the Union Pacific Railroad Company, and authorized this company to build a line of railroad and telegraph to the eastern boundary of California. The "initial point" of this railroad line was to be "on the hundredth meridian of longitude west from Greenwich, between the south margin of the valley of the Republican River and the north margin of the valley of the Platte River, in the Territory of Nebraska, at a point to be fixed by the President of the United States, after actual surveys"; that is, near Fort Kearney, in the center of Nebraska Territory, 249 miles west of Omaha. From this "initial point" four several branches were to extend eastward to the cities of Sioux City, Omaha, Atchison, and Kansas City. The Union Pacific Railroad Company was to build the "Iowa branch," that is, the line from Omaha, on the eastern boundary of Nebraska,¹⁹

¹⁸ 12 Stat. L. 489.

¹⁹ Strictly speaking, the road was to begin at "a point on the Western boundary of Iowa, to be fixed by the President of the United States." President Lincoln fixed

westward to the "initial point" on the hundredth meridian. A Kansas corporation, the Leavenworth, Pawnee, and Western Railroad Company, was to construct the branch from Kansas City to the hundredth meridian. The Hannibal and St. Joseph Railroad, a Missouri company, was authorized to build westward from St. Joseph through Atchison until it should effect a junction with the Kansas City branch, 100 miles west of the Missouri River. The act provided that as soon as a railroad through Minnesota or Iowa should connect Sioux City with the east, the Union Pacific Railroad Company was to build a branch to Sioux City. It was intended that these four lines should converge towards and meet at the "initial point," near Fort Kearney; and from that point the Union Pacific was to continue to build westward to the eastern boundary of California. The Central Pacific Railroad Company of California, a corporation already existing under the laws of California, was to construct that portion of the through line which lay within that state. Whichever of these two roads, the Union Pacific or the Central Pacific, should first reach the California state line was to build eastward or westward, as the case might be, until it effected a junction with the other.²⁰

The effect of this act, therefore, was to incorporate the Union Pacific Railroad Company and to authorize that company to build a line of railroad and telegraph from the Missouri River to California. A board of 162 commissioners was named in the act who were to open books of subscription to the capital stock in the "principal cities of the country." The authorized capital stock of the company was limited to \$100,000,000, or 10,000 shares of \$1,000 each. The act required subscribers to the stock to pay the par value of their

this point "within the limits of the township in Iowa opposite the Town of Omaha, in Nebraska."

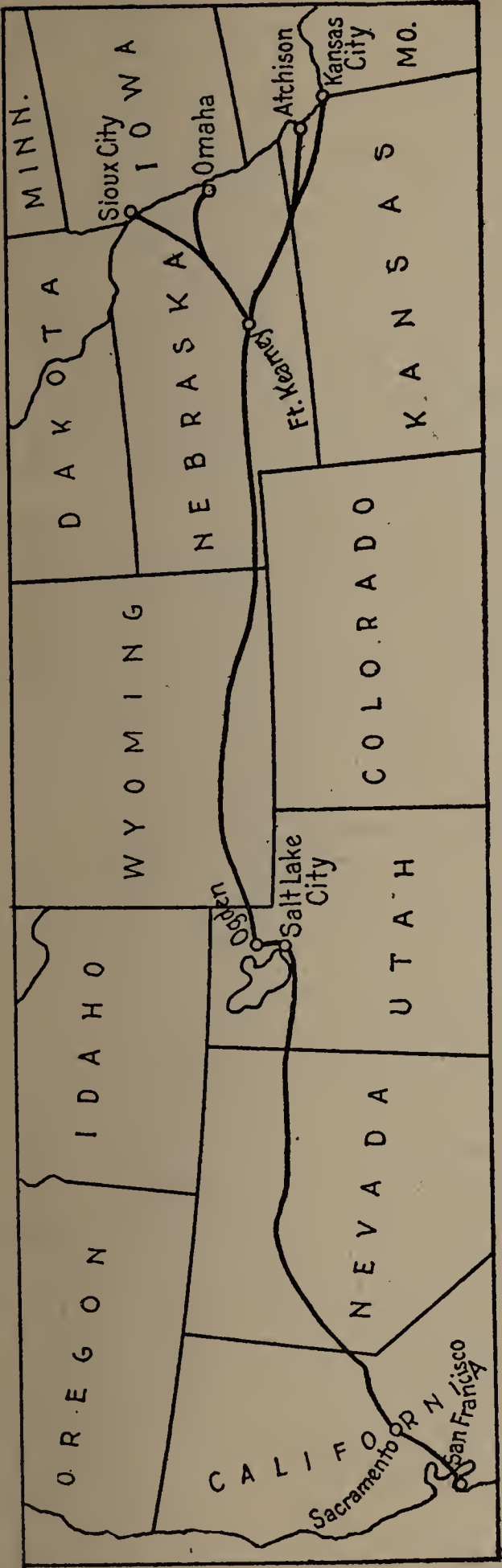
²⁰ The requirement that the Union Pacific build the Sioux City branch was changed in 1864; that branch, from Sioux City to Fremont, Nebraska, a station on the main line of the Union Pacific, was later built by the Sioux City and Pacific Railroad Company. The branch extending west of Atchison was constructed by a corporation known as the Central Branch Union Pacific Railroad Company. (See map, page 13.)

subscriptions in cash: 10 per cent at the time of subscription, the balance in semiannual assessments of 5 per cent each. As soon as 2,000 shares had been subscribed and 10 per cent thereon paid in, the subscribers were authorized to organize and to elect officers and a board of directors. The directors were to be fifteen in number, two of whom were to be appointed by the President of the United States. These "government directors" were to own no stock in the company, but were to represent the interests of the government.

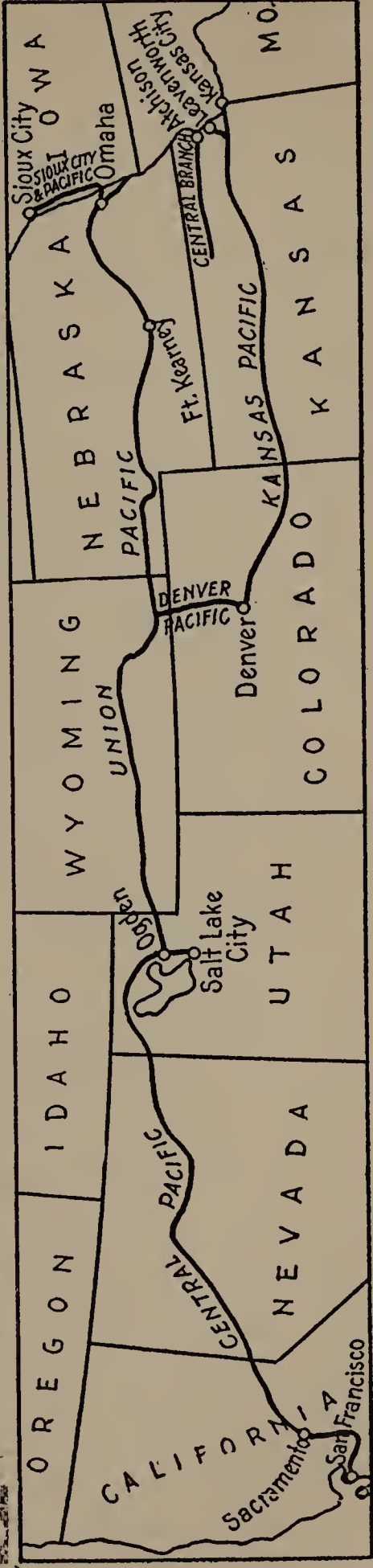
Land Grant and Bond Subsidy

The United States granted to the Union Pacific Railroad, and to the other companies mentioned in the act, a right of way through the public lands, and agreed to extinguish Indian titles where they conflicted with the interests of the railroads. In addition to the right of way, the United States made to each of the companies a grant of ten alternate sections of public land, five full sections on each side of the track, for each mile of railroad that was built. Mineral lands were specifically excepted from the grant, but timber lands were included. Lands not sold or disposed of within three years after the road's completion were, under the terms of the act, subject to pre-emption at \$1.25 per acre, to be paid to the company. Land patents were to be issued upon the application of the respective companies as each consecutive 40 miles were completed to the satisfaction of three government commissioners appointed for the purpose of examining and reporting upon the progress and condition of the road.

The act provided further that as each consecutive 40 miles of railroad were constructed upon the level plains, the Secretary of the Treasury was to issue to the Union Pacific, or to any of the other companies, as the case might be, bonds of the United States at the rate of \$16,000 per mile of completed road. For 150 miles west from the eastern base of the Rocky Mountains, and for 150 miles east from the western base of



Pacific Railroad System as Originally Contemplated.



Pacific Railroad System as Actually Built.

the Sierra Nevadas, where the mountains were expected to add greatly to the cost of construction, the bond issue was to be \$48,000 per mile. For the portion of the route lying between the Rockies and the Sierras, the bond subsidy was fixed at \$32,000 per mile. The bonds so issued were to be United States 30-year 6 per cent currency bonds. They were declared by the act to constitute a loan; and to secure the repayment to the government of both principal and interest, their issue and delivery to the company receiving them was to constitute, *ipso facto*, a first mortgage upon its line of railroad and all appurtenances thereto.

The companies receiving this aid were required to keep their roads in repair, and to be ready to perform such services by way of transporting mails, troops, and supplies, as the government might require. Such compensation as the government should properly owe the companies for their services was to be retained by the United States and applied to the payment of the bonds and the interest thereon. After "said road is completed" 5 per cent of the net earnings of each company was to be applied annually toward extinguishing its debt to the government.

Until the entire road from the Missouri River to California was completed, the government was to retain 25 per cent of the bonds to be issued for the level portion of the Union Pacific east of the hundredth meridian, and for the level portion of the Central Pacific west of Sacramento, and 15 per cent of the bonds to be issued for the more difficult region between the hundredth meridian and Sacramento. Failure of any one of the companies to comply with the conditions of the act was to work a forfeiture of its franchise; but any company complying with its provisions was to be entitled to its benefits.

The act provided also that the iron used in the construction and equipment of the road should be American. This re-

quirement, which was admittedly intended to benefit the domestic iron industry, greatly increased the ultimate cost of construction. Another provision gave to Congress the power to reduce rates whenever the net earnings of the entire road²¹ for any one year should exceed 10 per cent of the road's cost. Congress also reserved the right to add to, alter, amend, or repeal this act, having due regard for the rights of the companies named therein.

Since the bonds were United States bonds, the interest thereon after their issuance was paid by the government. This act, however, contained no definite provision regarding the time when the companies were to repay this interest. Interest was to be repaid; but whether repayment was to be made semi-annually, or when the bonds matured, was left doubtful. This appears to have been done purposely. An amendment requiring the companies to repay to the government the semi-annual interest within 30 days after it fell due was voted down.²² It appears from the debates in Congress that the annual sum to be retained by the government for transportation was expected to be sufficient to meet the interest as it accrued.

It should also be observed that while the railroads were to pay annually into the United States Treasury "5 per cent of their net earnings," net earnings were not defined. Moreover, while the government retained the right to regulate rates when net earnings should exceed 10 per cent of the cost, not only were net earnings not defined, but there is no suggestion as to how the term "cost" should be construed. This statute, apparently plain as to its intent, was loosely drawn, and in the unhappy obscurity of certain of its provisions were the seeds of bitter contention and future litigation over its construction.

²¹ It is impossible to say whether the phrase "entire road" refers to the Union Pacific alone, or includes the other lines named in the act. This is one of the ambiguous sections of the act.

²² Cong. Globe, 37th Cong., 2nd sess., p. 1911.

Early Organization

This act was approved by President Lincoln on July 1, 1862. Six months later, on January 8, 1863, work commenced in a half-hearted way on the Central Pacific; but upon the Union Pacific work was not begun until December, 1863. In accordance with the provisions of the statute, the board of commissioners appointed to receive subscriptions to the stock of the Union Pacific Railroad Company opened books of subscription. A few "patriotic individuals" subscribed small amounts in order "to save the charter." By the fall of 1863 the sum of \$2,177,000 had been subscribed, on which 10 per cent had been paid in.²³ As more than 2,000 shares had been subscribed and 10 per cent thereon paid in, it was now possible to effect a permanent organization. This was done in October, 1863. General John A. Dix, a prominent citizen of New York state, who had taken 50 shares of stock, was elected president. This man was, however, either unable or unwilling to take active charge of the company's affairs, although nominally he remained president for several years.²⁴ After its organization, the real control of the company was in the hands of the vice-president, Dr. Thomas C. Durant, a New York promoter who had in some way become interested in the Union Pacific Railroad.

Two months after the company was organized, the first ground was broken at Omaha, on December 2, 1863. The company made a few surveys and began some grading and preliminary work near Omaha.²⁵ The small sum paid in on the stock was expended, and in addition, the company incurred obligations amounting to over \$200,000 for iron, cars, locomotives, ties, and grading. No more funds being forthcom-

²³ House Report No. 78, 42nd Cong., 3rd sess. (serial No. 1577). The select committee of the House on the Affairs of the Union Pacific Railroad (Hon. J. M. Wilson, Chairman), Report and testimony, p. 740. This report will be hereafter referred to as the "Wilson Report"; references in Roman numerals refer to the report proper; references in Arabic numerals refer to the testimony.

²⁴ It seems that some of these early subscribers were men who took small amounts of stock merely to lend their names to the project, while others who subscribed were speculators or promoters of doubtful reputation. (See Davis, *The Union Pacific Railway*, p. 116.)

²⁵ Wilson Report, p. 63, testimony of T. C. Durant.

ing, work stopped. The company sold a portion of the materials which it had purchased in order to meet some of its obligations.²⁶

Whether the Union Pacific project failed to attract capital because of the tremendous financial risk involved in the construction and operation of such a road, or because individuals prominently connected with the company failed to inspire confidence in their integrity and soundness of judgment,²⁷ the work came to a standstill. To pass a Pacific Railroad Act was one thing, and to induce responsible capitalists to build the road was another. In 1864 it seemed unlikely that the road would ever be built under the act of 1862.

In the early spring of 1864, Vice-President Durant and some of his associates went to Washington to obtain increased grants for the railroad. Although they met with considerable opposition, for many of the members of Congress were opposed to any further grants, and a few were in favor of having the national government itself undertake the work rather than subsidize a private company,²⁸ nevertheless the promoters succeeded in inducing Congress to pass a bill making grants and subsidies greatly in excess of the aid given by the act of 1862. Since the grants made in the earlier statute had been insufficient to invite capital to embark on the undertaking, many members believed that larger inducements should be offered. Other members preferred to vote for such a bill rather than go on record as opposing the construction of the Pacific railroad. So far as members from the western states were concerned, and especially from the states of California and Oregon, they were eager to grant any subsidy in order to insure the road's construction. The advocates of increased grants were further supported by the fact that President Lincoln was known to be

²⁶ *Ibid.*

²⁷ According to Davis, men of standing among the subscribers, such as General Dix, were not active in the management; the reputation of the company suffered from the fact that it was known to be controlled by men like Durant and George Francis Train. (See Davis, *The Union Pacific Railway*, pp. 116 ff.)

²⁸ See speech of Rep. Pruyn in the House, *Cong. Globe*, 38th Cong., 1st sess., p. 3149.

strongly in favor of additional aid.²⁹ A bill providing for larger subsidies was passed in June, 1864, and on July 2 it received President Lincoln's signature.³⁰

The Act of 1864

The amendatory act provided³¹ that the capital stock of the Union Pacific was to be limited to 1,000,000 shares of \$100 each, instead of 100,000 shares of \$1,000 each. The total number of directors was increased from fifteen to twenty, and the number of government directors was increased from two to five. The land grant was doubled, so that for each mile of completed railroad the company was to receive twenty sections of land, ten alternate sections on each side of the track. Mineral lands, which the earlier act had exempted from the land grant, were now declared not to include coal and iron lands. Under the new act the company was entitled to receive land patents and subsidy bonds as each 20 miles of road were completed and accepted, instead of being required to wait until the completion of each 40 miles, as provided in the act of 1862. These provisions applied to the Central Pacific and to the branch lines, as well as to the Union Pacific.

The most immediately important concession, however, was that part of the act which authorized each of these companies to issue its own first mortgage bonds on its "railroad and telegraph lines to an amount not exceeding the amount of the bonds of the United States, and of even tenor and date, time of maturity, rate and character of interest with the bonds authorized to be issued to said railroad companies respectively"; and which provided further that the lien of the government subsidy bonds be subordinated to the lien of these first mortgage bonds of the several companies, except as to "the

²⁹ Wilson Report, p. 551, testimony of Cornelius Bushnell; speech of Oakes Ames, Cong. Globe, 42nd Cong., 3rd sess., p. 1723; Gen. Dodge, *How We Built the Union Pacific Railway*, p. 11.

³⁰ In the House of Representatives the vote was 70 to 38, 74 not voting. (Cong. Globe, 28th Cong., 1st sess., p. 3267.)

³¹ 13 Stat. L. 356.

transmission of dispatches and the transportation of mails, troops, munitions of war, supplies and public stores for the Government of the United States.”³² Thus by changing its lien securing its loan from a first mortgage to a second mortgage, the government made it possible for these companies to borrow additional sums on roads which were largely built with the moneys loaned by the government.

The act of 1864 made two other important concessions. Instead of requiring the companies to apply toward the payment of the subsidy bonds the entire amount due them for services performed for the government after the roads were completed, the companies were by this act permitted to collect from time to time one-half of the sum due them on the government's account. The act of 1864 also not only repealed that section of the former act which provided that the government was to retain a portion of the bond subsidy until the roads were completed; but it was now provided that when the railroad companies had prepared a portion of their roadbeds for the superstructure, subsidy bonds for the portions so prepared equal to two-thirds of the amount to which the companies would be ultimately entitled should be issued to them in advance of the track-laying, the other third to be reserved until the rails were laid. This provision was limited, however, to the work between the eastern base of the Rockies and the western base of the Sierras.

The provision regarding the Sioux City branch was modified, so that responsibility for its construction was taken away from the Union Pacific Railroad Company and entrusted to a separate corporation.³³

How Dr. Durant and his fellow-promoters worked to obtain these increased grants and enormous concessions will

³² By this exception it was evidently intended to preserve to the government its prior rights to the use of the railroads of the several companies for the purposes above enumerated, as against any rights the first mortgage bondholders might otherwise be entitled to.

³³ This branch, which was built by the Sioux City and Pacific Railroad Company, never became important as a part of the Pacific railroad system. The branch was built for the subsidy, and subsequently became part of the Chicago and Northwestern system.

probably never be known definitely. What went on behind the scenes in Washington at this time will doubtless remain a sealed book. A subsequent investigation disclosed the fact that in spite of the desperate condition of the Union Pacific treasury, the sum of \$435,754.21 was spent in Washington during this time, and was charged upon the company's books as a "suspense account."³⁴ No vouchers were ever produced regarding the disposition of this money. Nearly all of it was entered in the name of Dr. Durant. While there is no proof that this money was used improperly to influence members of Congress, no satisfactory explanation of the disposition of this large sum has ever been made. One lobbyist, a lawyer named Joseph B. Stewart, subsequently admitted having received \$30,000 for his individual services in procuring the passage of the act of 1864,³⁵ but refused to disclose how a sum amounting to over \$200,000 which passed through his hands was disbursed.³⁶ Stewart declared that his professional honor to his clients and his unwillingness to disclose their private business transactions were the reasons for his refusal to explain how this money was spent.

The passage of an act making increased grants was at one time doubtful, owing to the jealousies of rival localities and the conflicting interests of rival branches of the Pacific railroad.³⁷ A portion of this curious "suspense account" was, it appears from the evidence, expended in quieting the rivalry of these branches and of these localities.³⁸ A fair inference is that all of this money was in some form or other used in lobbying. Many have believed and asserted that this fund was a corruption fund used to corrupt members of Congress; but on this point nothing definite has been established.³⁹ The con-

³⁴ Wilson Report, p. 137, copy of account.

³⁵ *Ibid.*, p. 175, testimony of J. B. Stewart.

³⁶ *Ibid.*, p. 177, testimony of Stewart.

³⁷ *Ibid.*, pp. 127, 128, testimony of Durant; pp. 173-179, testimony of Stewart; and the testimony of other witnesses. See Cong. Globe, 38th Cong., 1st sess., pp. 2376 ff., 2403, 2404, and other places.

³⁸ *Ibid.*, pp. 105 ff., testimony of Durant; pp. 299 ff., testimony of Oliver Ames.

³⁹ *Ibid.*, p. XVIII.

stant presence of paid lobbyists, whose business it was to secure additional aid for the Pacific railroads is frequently referred to in the debates of Congress over this question, in 1864. It is interesting to note that among these lobbyists was a notorious and erratic promoter, named George Francis Train.⁴⁰

The Pacific Railroad Acts of 1862 and 1864 form the charter of the first Union Pacific Railroad Company. The Union Pacific and the other companies named were to receive an unconditional grant of land of twenty sections for each mile,⁴¹ as well as a 30-year loan of United States bonds at the rate of \$16,000, \$32,000, or \$48,000 a mile, respectively, according to an arbitrary division of the line, based on anticipated difficulties of the construction. The acts contemplated that the additional funds necessary for the work should be raised by means of stock subscriptions and first mortgage bonds. Dr. Durant and his friends were apparently satisfied with the increased grants made by the act of 1864, and proceeded now to place a portion of the work under contract.

The Pacific Railroad Acts are among the most extraordinary, as well as important, acts ever passed by Congress. Congressional grants of land in aid of railroads were not unusual both before and after the Civil War; but this is the only instance where the national government aided a railroad by practically guaranteeing a portion of its bonded debt. Although the grants were generous, the obstacles which apparently stood in the way of the road's completion were large, and in the eyes of many, insuperable. The situation as it was in 1862 is well summed up in the words of one of the representatives who spoke in favor of the passage of the act of 1862:

This road could never be constructed on terms applicable to ordinary roads. Every member of the committee knows

⁴⁰ Cong. Globe, 38th Cong., 1st sess., p. 3149, speech of Rep. Washburne of Illinois.

⁴¹ The clause of the act of 1862 which opened to pre-emption lands not sold or disposed of within three years became a dead letter.

that it is to be constructed through almost impassible mountains, deep ravines, cañons, gorges, and over arid and sandy plains. The Government must come forward with a liberal hand, or the enterprise must be abandoned forever. The necessity is upon us. The question is whether we shall hold our Pacific possessions, and connect the nations on the Pacific with those on the Atlantic Coast, or whether we shall abandon our Pacific possessions.⁴²

⁴² Cong. Globe, 37th Cong., 1st sess., p. 1912, speech of Rep. Holman. The Pacific railroad legislation is exhaustively discussed from the historical and political standpoint in Davis, *The Union Pacific Railway*.

CHAPTER II

THE HISTORY OF THE CONSTRUCTION CONTRACTS

Construction Company Method of Railroad Finance

The acts of 1862 and 1864 contemplated a railroad which was to be built with money raised from three sources: cash subscriptions to the capital stock, a government subsidy, and first mortgage bonds. Congress unfortunately failed to take into consideration one important economic fact, which was that the method of financing railroad construction by means of cash subscriptions to the capital stock was then no longer employed in the construction of new railroads. Formerly this had been done, with the result that the money invested in early railroads was usually lost. To invest money in the stock of a projected railroad had been found to be extremely hazardous. At best, dividends could be expected only after a long period of waiting. The experience of early railroad promoters stimulated the development of some scheme whereby the danger of loss in new railroad construction would be eliminated and the chances of profit to the promoters made less uncertain. The desired end was attained through the construction company. For some reason railroad bonds inspired a confidence which railroad stock did not, so that it was much easier to float a bond issue than to secure stock subscriptions. Railroad promoters learned that by issuing mortgage bonds they could usually raise the capital necessary to build their roads. By organizing themselves into a construction company, promoters, as controlling stockholders of the railroad company, could vote construction contracts to themselves at exorbitant prices. The actual cost of construction could be met out of a bond issue, and it was often found possible to bond a road at a figure con-

siderably in excess of its probable cost. The aim of railroad promoters was to pay in as little as possible on the stock which would usually be gratuitously issued to themselves, and to raise as much capital as possible out of a bond issue. By this expedient the financial risk fell on the bondholder, while, if the road proved a success, the promoters, who were stockholders in the construction company, would receive whatever advantage might go with ownership of the stock, besides salaries, jobs, and employment, and dividing whatever profits might be made by the construction company. Only a small percentage of a railroad company's stock represented actual investment.¹

If capitalists had found that it was an uncertain financial venture to employ the stock subscription method in constructing a new railroad in the east or middle west, there was infinitely greater hazard in risking money in the stock of a railroad which was to run for hundreds of miles through an uninhabited region, a great part of which was desert land, through a country where there was little expectation of the local traffic necessary to sustain a railroad. Indian disturbances and the expense of crossing a high range of mountains added to the risk. That such a railroad, much as the nation's interests demanded its construction, should not invite capital to subscribe to its stock was to be expected.

Nevertheless, while its construction involved serious risks, the Union Pacific Railroad was the potential owner of large assets. A generous land grant, which the building of a railroad would make valuable, would become available as fast as the track was laid. The company was also to receive a subsidy of government bonds which, while they were to be an obligation of the road, were not to mature for 30 years. The obsolete cash stock subscription method of railroad building did not commend itself to Vice-President Durant and his fellow-promoters, who desired a more immediate and a surer return. To

¹ For a comprehensive outline of this phase of the history of American railroad construction, see an article by Charles Francis Adams, Jr., entitled "Railroad Inflation," in the *North American Review*, Jan. 1869.

get possession of the road's assets by diverting them from the corporation to themselves as individuals was their object. This end they could attain by the familiar method of organizing themselves into a construction company and voting to themselves the contracts for the road's construction. The amendatory act of 1864 increased the assets which would become available after each 20-mile stretch of road was built. The land grant was doubled, and the railroad company was permitted to issue its own first mortgage bonds, which were to be a lien prior to that of the government loan. The total potential resources of the railroad therefore included first mortgage bonds, government bonds, a land grant of twenty sections a mile, and whatever subordinate securities or stock it might subsequently be possible to issue. The construction company method was employed. The promoters let construction contracts to themselves at excessive prices, and as a consequence the capitalization of the completed road was nearly double the amount which was actually expended in the work.

The Hoxie Contract

In May, 1864, a committee of the Union Pacific officials was appointed to let a contract for a portion of the road's construction.² On the 8th of the following August this committee received a formal proposition from a Mr. Herbert M. Hoxie for the construction and equipment of the first hundred miles of railroad west of Omaha. Hoxie was an employee of the company, and, it seems, his means were so limited as to be out of all proportion to the magnitude of the undertaking³; but Mr. Durant and his associates found it convenient for their purposes to use his name. On September 23, 1864, the company formally accepted Hoxie's proposition. A contract was drawn up,⁴ by the terms of which the contractor agreed to build

² Wilson Report, p. 63, testimony of Durant.

³ *Ibid.*, p. 256, testimony of Oliver Ames. This statement agrees with most of the testimony, but one witness testified to the contrary. See p. 151, testimony of Oliver W. Barnes.

⁴ For copy of the contract, see Wilson Report, Pt. 2, p. 2.

and equip 100 miles of railroad, including side-tracks not to exceed 6 per cent of the main line, at \$50,000 per mile. In case the railroad company wished to have ties burnetized,⁵ the additional expense, 16 cents for each tie, was to be borne by the company. The contractor was not required to expend over \$85,000 for any one bridge;⁶ nor was he required to spend over \$5,000 per mile, or \$500,000 in the aggregate, for station buildings, machinery, tanks, or equipment. Any excess in the cost of iron over \$130 a ton was to be borne by the company. The contractor on his part agreed to guarantee funds on the company's first mortgage bonds at 80 per cent of their par value, and on the company's land grant mortgage bonds at 70 per cent of their par, and to subscribe, or cause to be subscribed, \$500,000 to the capital stock of the Union Pacific Railroad Company.

On October 4, 1864, eleven days later, the contract was extended to the hundredth meridian, 247 miles west of Omaha; and the amount which the contractor agreed to subscribe to the company's capital stock was increased to \$1,000,000.⁷ Three days later Hoxie agreed to assign his contract to such persons as Durant should designate. On the same day, five men, T. C. Durant, Cornelius Bushnell, C. A. Lambard, H. S. McComb, and H. W. Gray, drew up an agreement by which they together subscribed \$1,600,000 to carry out the Hoxie contract.⁸ Each one of these five men was to have an interest in whatever profits might be made out of the contract in proportion to the amount of his subscription.

Hoxie never was expected to carry out the contract. As soon as he obtained it he transferred it to the five men named above. The first four who were named were directors of the railroad company, while Mr. Gray was a stockholder. These

⁵ Burnetizing is a process by which ties are chemically treated so that they become more durable. This process was necessary in the case of the cottonwood lumber which made up a large part of the tie supply of the Union Pacific.

⁶ The reason for this provision was that there was one bridge a short distance west of Omaha which was expected to cost \$100,000.

⁷ Wilson Report, Pt. 2, p. 4.

⁸ *Ibid.*

men therefore became the contractors who were to build the road. For their relatively small initial outlay they would receive the excessive contract price in government subsidy bonds, company first mortgage bonds at 80 cents on the dollar, land grant bonds at 70 cents on the dollar, and stock of the railroad company. Although the charter required stock subscriptions to be paid in cash at par, this provision was evaded by the clause in the contract under which the contractors bound themselves to subscribe to the stock. The intention was that the contractors should subscribe to the railroad company's stock and pay for it with a check; the same check without going through the bank would be returned to the contractors as a payment on account of the contract. They called this a "cash" transaction. It was the method actually carried out later, and by reason of the excessive contract price amounted substantially to issuing the stock as a gratuity.⁹ The amount of cash which these men had invested in the stock of the railroad company, which gave them control of its management, was trifling compared with the profits which they hoped to make out of the construction.

The chief engineer of the company in 1864 was Peter A. Dey. Mr. Dey had made numerous surveys over the general route of the projected road, and he had estimated the cost of its construction at about \$30,000 a mile for the first hundred miles, and \$27,000 a mile for the next hundred. These estimates, according to Mr. Dey, were extremely liberal, even taking into account the excessive cost of labor and materials during the war.¹⁰ Dey submitted this estimate to Vice-President Durant; but Durant instructed him to raise his figures, on the ground that the embankments provided in Dey's estimates were not sufficiently wide, and that his proposed grade over the hills just west of Omaha was too steep. Dey reluct-

⁹ Wilson Report, p. 250, testimony of Oliver Ames.

¹⁰ *Ibid.*, p. 240, testimony of Dey; also see Sen. Exec. Docs. No. 51, 50th Cong., 1st sess. (serial Nos. 2505-2509, inclusive), being the report of and testimony taken by the United States Pacific Railway Commission of 1887; p. 1426, testimony of Dey. This document will hereafter be referred to as "Pac. Ry. Com."

antly obeyed Durant's instructions. He raised his estimate to \$50,000 a mile, his new specifications calling for heavy embankments where he thought such embankments were not needed, and for a reduction of the grade to a point which he believed impracticable.¹¹ Late in the fall of 1864 he received a copy of the Hoxie contract. This contract adopted the contract price of Dey's second estimate, \$50,000 a mile, but disregarded his revised specifications and provided for a road of the same physical character called for by his first estimate.

The contract price of \$50,000 a mile was very much in excess of what Dey believed it would cost to build the road under the Hoxie specifications. By the terms of the contract, \$5,000 a mile was to be the maximum amount which the contractor was required to spend above the amount necessary for iron, grading, ties, and track-laying. This sum, Dey believed, was utterly insufficient to cover the items which it was intended to cover. The cost of iron to the contractor was limited to \$130 a ton, or about \$13,000 per mile.¹² The large margin of \$32,000 per mile remained, out of which the contractor was required to pay only the cost of ties and grading. By the contract the company's securities were scaled down to 80 per cent in the case of the first mortgage bonds and to 70 per cent in the case of the land grant bonds, so that the road's corporate obligations were correspondingly increased. The practical effect of the contract, according to Mr. Dey, was virtually to compel the railroad company to pay about \$60,000 a mile for the construction. An enormous burden of debt was therefore placed upon the road at the very outset. As it appeared to Dey, his second and larger estimate was merely an attempt on the part of the officers to justify this contract, while the additional work which his later specifications required was not to be performed.

When Dey saw that his professional advice was thus dis-

¹¹ Pac. Ry. Com., testimony, p. 1425; Wilson Report, p. 676, testimony of Dey.

¹² The rails used weighed 56 pounds to the yard, so that the cost of iron amounted to slightly less than \$13,000 per mile if iron cost \$130 a ton.

regarded in such an important matter, he resigned. His letter of resignation reads as follows:¹³

Engineer's Office,
Union Pacific R. R.,
Omaha, Dec. 7, 1864.

DEAR SIR: I hereby tender you my resignation as chief engineer of the Union Pacific Railroad, to take effect Dec. 30, 1864, one year from the date of my appointment. I am induced to delay until that time that I might combine the results of surveys of the present year and present them to the company and to myself in a satisfactory manner. My reasons for this step are simply that I do not approve of the contract made with Mr. Hoxie for building the first hundred miles from Omaha west, and I do not care to have my name so connected with the railroad that I shall appear to endorse this contract. Wishing the road success beyond the expectation of its members,

I am, respectfully yours,

PETER A. DEY.

HON. JOHN A. DIX.

In a subsequent letter to General Dix, Dey pointed out the danger of overcapitalizing the road at the very start.¹⁴ He cited as an example of the effect of overcapitalization, the Mississippi and Missouri Railroad, now the Rock Island, a road with whose construction Dr. Durant had been prominently connected. This road had met with financial reverses which had temporarily prevented its completion, as a result of the inflation policy of its builders. Mr. Dey's testimony as to the probable cost of building the Union Pacific is valuable, for he was an experienced civil engineer who had been actively engaged in reconnaissances and surveys in the far west. His successor, General Granville M. Dodge, speaks in the highest terms of his efficiency, integrity, and soundness of judgment.¹⁵

The parties to the agreement of October 7, 1864, had subscribed the sum of \$1,600,000 for the purpose of carrying out

¹³ Wilson Report, p. 669.

¹⁴ *Ibid.*, p. 670.

¹⁵ Dodge, *How We Built the Union Pacific Railway*, p. 6.

the Hoxie contract. Of this amount 25 per cent had been paid at once. When it became time for the subscribers to pay the second instalment on their subscriptions, they became frightened at the risk of their undertaking; for they were working under a simple partnership arrangement, and in case the venture should prove unprofitable these men would be jointly liable to the extent of their individual fortunes for the entire amount of whatever obligations might be incurred in carrying out the contract. If the statements of some of the promoters are to be believed, they were unwilling to go on without the protection afforded by a limited liability corporation, preferring to lose what they had already paid in rather than to proceed in an arrangement in which there was no limit to individual liability.¹⁶

Credit Mobilier

In 1859, before the day of the general incorporation law, the Pennsylvania legislature had granted a corporate charter to a company known as the Pennsylvania Fiscal Agency.¹⁷ The corporation thus created never transacted any active business. Its charter gave it almost unlimited powers. In March, 1864, Dr. Durant purchased the charter of this company.¹⁸ Its name was then changed to the Credit Mobilier of America. The men who had entered into the partnership agreement to carry out the Hoxie contract concluded to organize under this charter, and so avoid the financial risk which a simple partnership involved. The plan was carried out. The company's organization was perfected. Its capital stock was fixed at \$2,000,000, and was later increased to \$2,500,000. Other men besides the original group of five became interested in the Credit Mobilier.

By an agreement drawn up on March 15, 1865, between

¹⁶ Wilson Report, p. 64, testimony of Durant.

¹⁷ Laws of Pennsylvania, 1860, p. 896.

¹⁸ Wilson Report, p. VII. The name "Credit Mobilier" is said to have been suggested by George Francis Train, who had spent a great deal of time in France, where a French corporation called the Credit Mobilier of France was at that time prominently engaged in financing railroad and other enterprises of internal improvement.

H. M. Hoxie and the Credit Mobilier of America, the Credit Mobilier guaranteed the performance of the Hoxie contract. In return :

Said Hoxie agrees to and hereby does assign to said Credit Mobilier¹⁹ all his right to have and receive from said company, securities, stocks, moneys, profits, and payments, due or to become due for constructing the railroad or other performance of said contract.

Hoxie was to be paid \$5,000 in cash and \$10,000 in Union Pacific stock.²⁰ It was arranged that the previous subscriptions made by the group under the partnership agreement, amounting to \$1,600,000, were to apply toward subscriptions to the stock of the Credit Mobilier.²¹

The Credit Mobilier's place of business was nominally in Philadelphia; but its real business was transacted at its New York "branch office," which adjoined the general offices of the Union Pacific Railroad Company. The Credit Mobilier bought up what Union Pacific stock was outstanding and made a reissue among its shareholders; thus the stockholders in the two corporations became identical.²²

Until the spring of 1865 work on the road had languished, but now under the Credit Mobilier arrangement construction proceeded rapidly on the first 247 miles. The Credit Mobilier's capital stock, for which cash was paid, furnished the funds to meet such outlays as were immediately necessary. The government subsidy bonds became available with the completion of each 20 miles, and it was hoped that the railroad company's bonds might find a market when once the work was well under way. There was still a large element of risk, but the profits promised to be enormous. Construction went ahead during

¹⁹ Thus Hoxie carried out his agreement to assign his contract to such persons as Durant should designate.

²⁰ Wilson Report, Pt. 2, p. 6.

²¹ House Report No. 77, 42nd Cong., 2nd sess. (serial No. 1577). The select Committee charged with investigating the Credit Mobilier (Hon. Luke P. Poland, Chairman) Report and Testimony, p. 366, testimony of Durant. Hereafter this report will be referred to as "Poland Report." References in Arabic numerals are to the testimony, and references in Roman numerals are to the report.

²² Wilson Report, p. VII. Some subscriptions had been made to Credit Mobilier stock by persons who were not shareholders of the railroad company until later.

the years 1865 and 1866, and on October 5, 1866, these 247 miles were completed.

In the meantime a new group of men had become connected with the Union Pacific. Oakes Ames, a representative in Congress from a Massachusetts district, became interested in the project while he was a member of the House Committee on the Pacific Railroad. Both Oakes Ames and his brother Oliver were capitalists of large means. Their connection with the Union Pacific commenced in 1865, when they became stockholders in the Credit Mobilier.²³ A number of their friends and business associates became interested at the same time, among whom were John B. Alley, Sidney Dillon, Rowland G. Hazard, and several others. The names of some of these men appear on the list of Credit Mobilier stockholders of March 15, 1865.²⁴ About the same time and by virtue of their interest in the Credit Mobilier, these men became stockholders in the Union Pacific Railroad Company. At the election of October 3, 1866, Oliver Ames became a member of the board of directors of the railroad company.²⁵ A short time afterward General Dix resigned as president of the road, and Oliver Ames was elected to succeed him.

Friction between Ames and Durant Factions

Considerable friction arose between the newcomers on the one side, and Dr. Durant and his friends on the other. Dr. Durant and the original promoters had shown very plainly that it was their purpose to make as much as possible out of the construction contracts, regardless of what might be the ultimate effect of their policy upon the fortunes of the road.²⁶ The Ames brothers and their associates were not unwilling to

²³ Wilson Report, p. 241, testimony of Oliver Ames. The name of Oakes Ames does not appear in the subscription list of March 15, 1865, but that of his brother is in the list as the holder of 2,000 shares. From the subscription list of May 18, 1866, it appears that on that date Oakes Ames owned 900 shares, and Oliver Ames 3,125 shares of Credit Mobilier stock. (Wilson Report, p. 155.)

²⁴ *Ibid.*, p. 160.

²⁵ *Ibid.*, p. 598.

²⁶ According to John B. Alley's sworn statement, Durant had one time declared that anyone who expected that the road when completed would be a commercial success was a "_____ fool." (Poland Report, p. 87, testimony of Alley.)

profit by the construction company method, through which they would be enabled to acquire for relatively small consideration large blocks of the railroad company's bonds and stocks; but it seems they believed in the ultimate success of the road as a business venture. The difference in the points of view of these two men, Durant and Ames, appears to have been with respect to the source whence the principal profit should be derived. Oakes Ames seemed to be of the belief that the bonds and stock of the company would upon the road's completion become sound investments,²⁷ while Durant expected to unload his securities as fast as possible after the road was completed. It is significant that according to the stock list of the Union Pacific Railroad Company, Dr. Durant was on February 26, 1870, about nine months after the road's completion, the owner of 36,522 shares of capital stock, which he had received by virtue of his interest in the various construction contracts,²⁸ and that during the next two years he parted with all his holdings except four shares; while the Ames family did not part with their holdings, Oakes Ames owning in 1872, 4,661 shares, Oliver Ames owning 31,833 shares, and the aggregate additional holdings of other members of the Ames family amounting in the same year, 1872, to about 2,000 shares.²⁹ At no time in the company's history has the Ames family been unrepresented upon the directorate.

The Ames people determined upon a change of management. They have asserted that when they entered the Credit Mobilier, they discovered grave irregularities. John B. Alley later testified that \$41,000 were charged upon the company's books as the cost of obtaining the charter of the Pennsylvania Fiscal Agency, while the actual sum so expended amounted to \$1,600.³⁰ Mr. Alley referred also, as an example of Durant's

²⁷ Poland Report, p. 16, testimony of Oakes Ames; p. 98, testimony of Alley.

²⁸ Wilson Report, p. 605.

²⁹ *Ibid.*, p. 601.

³⁰ Poland Report, p. 88, testimony of Alley. Oliver W. Barnes, from whom Durant obtained the charter, swore the cost was about \$30,000. (Wilson Report, p. 140.) It is difficult to establish either the truth or the falsity of the charges and countercharges which were made against one another by the Ames and Durant factions.

mismanagement, to the extraordinary "suspense account" which was expended in 1864 in "secret service" work in Washington.³¹ Certain it is that the Ames brothers were not in accord with the general policy of Dr. Durant, and a quarrel which had its effect upon the subsequent contracts arose between the Ames party and the Durant group. Whatever may be the merits of this controversy, the Ames party determined to oust Dr. Durant from the management, both of the railroad company and of the Credit Mobilier.

Oakes Ames and his friends managed to obtain control of the Credit Mobilier, and forced Durant to retire from the Credit Mobilier presidency.³² In the railroad company the Durant party showed greater strength, so that the Ames people were not successful in their attempt to compel his retirement from the office of vice-president of the Union Pacific Railroad. As might naturally be expected, Durant resented these proceedings. From this time on, his policy can be explained only by his personal opposition to the men in control of the Credit Mobilier. In spite of the fact that he still owned over 5,000 shares of Credit Mobilier stock, he spared no effort to prevent it from obtaining another contract.

As the same men who were stockholders in the Credit Mobilier controlled the destinies of the Union Pacific as well, they could reasonably expect that when they had built the first 247 miles under the Hoxie contract, another similar arrangement would be made for the remaining construction. Not anticipating any difficulty in securing another contract, they voted, in the fall of 1866, to increase the capital stock of the Credit Mobilier from \$2,500,000 to \$3,750,000. Each stockholder of the Credit Mobilier was offered the right to subscribe to that company's new issue to an amount not exceeding 50 per cent of the Credit Mobilier stock which he already owned. In addition to Credit Mobilier stock, each subscriber received

³¹ Poland Report, p. 88. See also Wilson Report, pp. 297-302, testimony of Oliver Ames; pp. 310-316, testimony of Alley.

³² *Ibid.*, p. 87, testimony of Alley.

as a bonus Union Pacific first mortgage bonds to an amount equal to the amount of new Credit Mobilier stock to which he subscribed. Thus a subscription for \$1,000 of stock of the Credit Mobilier carried with it \$1,000 in Union Pacific first mortgage bonds.³³ The money paid on subscriptions to new Credit Mobilier stock, amounting in all to \$1,250,000, was turned over to the railroad company, and 1,250 of that company's first mortgage bonds were received in exchange. These bonds were then distributed among the Credit Mobilier shareholders, one bond for each subscription of \$1,000. The stockholders of the Credit Mobilier, according to their own testimony six years later, were reluctant, because of the uncertain character of the investment, to make this additional subscription, but did so, they are careful to observe, because they were filled with a "patriotic desire to complete the road." This stock increase was made with a general understanding that the Credit Mobilier was to receive the contract for building the remainder of the road.³⁴

Temporary Contracts; the Boomer Contract

Dr. Durant's opposition to the new Credit Mobilier management upset their calculations, and it became clear that there might be some delay before the two factions in the Union Pacific would come to an agreement regarding a new contract. In the meantime work on the Central Pacific had been progressing. An act passed by Congress in 1866 authorized the Central Pacific to build east until it should meet the Union Pacific building west.³⁵ This act restored the earlier provision in the act of 1862 which had been modified by the act of 1864. In the region where the two roads were likely to meet, the

³³ Wilson Report, p. 40, testimony of Cornelius Bushnell. It was not until somewhat later that any very considerable sum was raised by the sale of Union Pacific bonds. (Poland Report, p. 179, testimony of Bushnell.)

³⁴ *Ibid.*, p. 41, testimony of Bushnell.

³⁵ 14 Stat. L. 79. The act of 1864 had amended the act of 1862 in favor of the Union Pacific as against the Central Pacific by providing that the latter road was to build only 150 miles east from the California line, instead of permitting it to build until it effected a junction with the Union Pacific.

government bond subsidy was \$32,000 a mile in addition to the land grant. Delay was the one thing all parties were anxious to avoid; if work on the Union Pacific were suspended while the opposing parties in the directorate were unable to agree over the contract for building west of the hundredth meridian, the Central Pacific would receive an advantage worth many thousands of dollars for every day the eastern road was idle. In order to forestall any such possibility, the directors of the Union Pacific voted to authorize the executive officers to make temporary contracts, subject to whatever general contract might later be made.³⁶ A resolution of the board provided that when the general contract was finally agreed to, it should commence at the hundredth meridian, that is, near Fort Kearney.³⁷

Upon his authority as vice-president and in pursuance of the resolution of the directors which has just been referred to, Dr. Durant on behalf of the railroad company contracted with a certain L. B. Boomer of Chicago for the construction of the first 150 miles beyond the hundredth meridian. This contract bore the date of November 10, 1866;³⁸ by its terms the price per mile, not including equipment, was to be \$19,500 from the hundredth meridian to the crossing of the north fork of the Platte River, and \$20,000 per mile west of that river. The cost of "station-buildings, depot-grounds, tank houses, or anything appertaining thereto, or equipment and rolling-stock" (about \$7,500 per mile), was not included in these figures. So far as appears from the face of this contract, it was, in comparison with the Hoxie contract, very favorable to the railroad company. The bridge over the North Platte was to be an additional charge, the railroad company being required to pay the cost of this structure. In order that work

³⁶ Wilson Report, p. 115, testimony of Durant.

³⁷ *Ibid.*, p. 119, testimony of Durant.

³⁸ For copy of the contract, see Wilson Report, Pt. 2, p. 7. Davis says that it was afterwards declared that the man Boomer existed only in Durant's "fertile imagination." He does not, however, give his authority for this statement. (Davis, *The Union Pacific Railway*, p. 166.)

might continue without interruption, the construction forces already employed were to be retained. This Boomer contract was never formally recognized by the directors, but work progressed under it until 58 miles more had been built and accepted by the government.³⁹ The money realized from the sale of Union Pacific first mortgage bonds to the Credit Mobilier when that corporation increased its stock, as explained above, furnished part of the necessary funds.

At a board meeting on January 5, 1867, while Durant was absent from New York, the directors of the Credit Mobilier, sitting and acting in their capacity as directors of the Union Pacific Railroad, passed a resolution extending the Hoxie contract to the point already completed, 58 miles west of the hundredth meridian, and authorized a settlement with themselves as members of the Credit Mobilier at the contract price of \$50,000 per mile. When Durant returned, he protested this resolution on the ground that this portion of the road had already been completed, and had been accepted by the government, at an approximate cost of \$27,500 per mile, including equipment. He enforced his protest by an injunction from a New York court, and compelled the directors to rescind their action.⁴⁰

The Two Williams Contracts

After the failure of this attempt to extend the Hoxie contract, a new move was made. On March 24, 1867, John M. S. Williams, a stockholder in both companies, proposed to construct the first 267.57 miles west of the hundredth meridian, including a portion of the work already constructed.⁴¹ For this work the railroad company was to pay him \$42,000 per mile for the first hundred miles and \$45,000 per mile for the remaining distance. He agreed also to procure subscriptions

³⁹ Wilson Report, p. 67, testimony of Durant.

⁴⁰ *Ibid.*, p. 68.

⁴¹ *Ibid.*, p. 70, testimony of Durant.

to the amount of a million and a half dollars to the stock of the Union Pacific Railroad. Williams had previously made an arrangement to assign this contract, in case he obtained it, to the Credit Mobilier. The directors accepted Williams' proposition, but Durant again protested; and as he backed up his protest with an injunction, the directors were unable to carry out this contract.⁴²

Another attempt was made in June. By this time 98¼ miles of road west of the hundredth meridian and about 346 miles west from Omaha had been built. Mr. Williams again offered to construct the 267.57 miles between the hundredth meridian and the eastern base of the Rockies, thus again covering the road already built, and fixed the price this time at \$50,000 per mile.⁴³ This proposal, however, shared the fate of both previous attempts of the Credit Mobilier to secure a contract.

Whatever view may be taken of the character of these three unsuccessful proposals, Dr. Durant's anxiety to prevent the directors from voting to themselves lucrative contracts is singularly inconsistent with his earlier policy.

The Oakes Ames Contract; the Seven Trustees; the Davis Contract

The dispute was settled in the summer of 1867, when the executive committee of the Union Pacific agreed to the famous contract with Oakes Ames. This was another contract made for the evident purpose of diverting, through excessive contract prices, the funds of the railroad company into the pockets of the Credit Mobilier stockholders. This Ames contract was for the construction of 667 miles west from the hundredth meridian, including the portion already constructed, at the following figures:⁴⁴

⁴² Wilson Report, p. 71, testimony of Durant.

⁴³ *Ibid.*, p. 162, testimony of J. M. S. Williams.

⁴⁴ *Ibid.*, Pt. 2, p. 10.

the first 100 miles at \$42,000 per mile.....	\$ 4,200,000
" next 167 " " \$45,000 " "	7,515,000
" " 100 " " \$96,000 " "	9,600,000
" " 100 " " \$80,000 " "	8,000,000
" " 100 " " \$90,000 " "	9,000,000
" last 100 " " \$96,000 " "	9,600,000
<hr/>	
667 miles to cost.....	\$47,915,000

The contract contained the following clause:

The party of the second part (Ames), his heirs, executors, administrators, or assigns, is to receive from the company and enjoy the benefits of all existing contracts, and shall assume all such contracts and all liabilities of the company accrued or arising therefrom for work done or to be done, and material furnished or to be furnished, for or on account of the road west of the hundredth meridian, crediting, however, the party of the first part in this contract (the Union Pacific) all moneys heretofore paid or expended on account thereof.

The contractor therefore was to receive the profit on that portion of the road west from the hundredth meridian which had already been built. By this time 138 miles of railroad had been constructed west from the hundredth meridian and had been accepted by the government as complete. These 138 miles were included under the Ames contract.⁴⁵

The contract price did not include the salary of either the chief engineer, the consulting engineer, or their immediate assistants; neither did it cover surveying expenses. The contractor was to be paid in cash obtained from the sale of government bonds and company first mortgage bonds; but if the government bonds could not be sold at par, or the first mortgage bonds at 90, the differences under these amounts were to be charged against the contractor. If the proceeds from the sale of these two classes of bonds, the one at par, the other at 90, were not sufficient to meet the contract price, the contractor was then required to subscribe the amount of such deficiency to the capital stock of the Union Pacific; the pro-

⁴⁵ Wilson Report, p. 259, testimony of Oliver Ames.

ceeds of this stock subscription were to be repaid to the contractor in settlement of his bill for the construction. The effect therefore of this arrangement was that the contractor was to receive government bonds at par, company first mortgage bonds at 90, and stock at par.

On October 1, 1867, the board of directors formally ratified the action of the executive committee in accepting the Oakes Ames proposition, subject however to the written consent of each Union Pacific stockholder. This condition Durant had insisted upon, ostensibly for the protection of the Union Pacific stockholders, before he finally consented to withdraw his injunctions.⁴⁶ Two weeks after the contract was accepted, Oakes Ames assigned it to a board of seven trustees, made up of the following men: Thomas C. Durant, Oliver Ames, John B. Alley, Sidney Dillon, Cornelius Bushnell, Henry S. McComb, and Benjamin E. Bates.⁴⁷ Thus Durant again obtained some control in the construction on the side of the contractors. Another and special agreement was drawn up between Oakes Ames, the trustees, and the Credit Mobilier of America. This agreement provided that the seven trustees were to administer the Ames contract in the interest of the stockholders of the Credit Mobilier as individuals. Any profits were to be divided among the stockholders of the Credit Mobilier in proportion to the stock which each one held. The arrangement was virtually to pay dividends on the Credit Mobilier stock; but the parties interested were emphatic in saying that except for a dividend of 12 per cent made late in the fall of 1866, when the securities received under the Hoxie contract were divided, the Credit Mobilier as such never declared a dividend. The profits which were later made and distributed under the Ames contract were claimed to be allotments made by the seven trustees among the stockholders of the Credit Mobilier, not dividends declared by the Credit Mobilier upon its capital stock.

⁴⁶ Wilson Report, p. 71, testimony of Durant.

⁴⁷ *Ibid.*, Pt. 2, p. 13.

No satisfactory explanation can be given why this trusteeship was adopted to set aside the simpler arrangement of acting through a corporation directly. It was a return to the partnership liability arrangement to avoid which the Credit Mobilier had been organized. Under the agreement assigning the contract it was provided that of those stockholders in the Credit Mobilier who were also stockholders of the Union Pacific, only those who executed to the trustees an irrevocable proxy to vote six-tenths of their Union Pacific stock, or of any Union Pacific stock they might thereafter receive as dividends or allotments in their capacity as stockholders in the Credit Mobilier, were to enjoy the profits of the Ames contract. This condition was readily complied with. The proxies were duly executed and the trusteeship became effective.⁴⁸

It was from this contract that the great profits were made. It appears that it was let under a misapprehension of the true character of the work. While under any circumstances the contract prices were high, yet it seems the directors did not know that the work of crossing the Rockies was neither so difficult nor so expensive as it was generally supposed. If the evidence of the company's officers is at all reliable, the men in the field had not even determined the route over the mountains, and no information was at hand except such as was afforded by the most general surveys. No estimates of the amount of material required were made until later.⁴⁹ The contract prices appear to have been fixed by guesswork. This was virtually admitted by Oliver Ames. When he was asked upon what basis the contract schedule of prices was fixed, he answered, "We had an idea that the country was pretty rough over the mountains, and that it would cost a good deal to go over them. That was the general report."⁵⁰

The discovery of the Evans or Sherman Pass over the

⁴⁸ These trustees and their friends owned practically all of the Union Pacific stock. It seems that the few stockholders that did not agree were bought out. (Wilson Report, p. 164, testimony of J. M. S. Williams.)

⁴⁹ Wilson Report, p. 255, testimony of Oliver Ames.

⁵⁰ *Ibid.*, p. 256.

range of mountains west of Cheyenne, in the summer of 1867, gave to the Union Pacific a comparatively easy line over the mountains. It was found that the rock was softer than had been expected, the grade was fairly even, and the elevation relatively low. Consequently the expense of building was considerably less than had been anticipated. This was apparently not known until late in the year 1867. This easy pass greatly lessened the actual cost of construction;⁵¹ but it was the contractors, not the railroad, that benefited by the discovery.

Work progressed rapidly under the Ames contract, and the 667 miles included in it were built during 1867 and 1868. The rest of the road, about 125 miles, was built under a contract made with a certain James W. Davis. The construction and equipment of the portion included in this arrangement with Davis was to be according to the same specifications and upon the same terms as the Ames contract had provided.⁵² Like the Ames contract, the Davis contract was assigned to the seven trustees, who carried out its terms. The road was completed to the junction with the Central Pacific, at Promontory, Utah, on May 10, 1869.

The Wardell Coal Contract

One other contract made during the construction period deserves brief mention. This is the contract made with the Wyoming Coal Company. Coal lands were under the act of 1864 included in the land grant. Surveys made by the company confirmed earlier reports of the existence of valuable coal mines along the line of the road, the principal deposits being at Rock Springs, Wyoming; Almy, Wyoming; and Grass Creek, Utah. On July 16, 1868, the Union Pacific Railroad made a contract with a Cyrus O. Godfrey and a Thomas Wardell, under which these two men were to prospect for coal on the Union Pacific lands, and to operate any mines

⁵¹ Wilson Report, p. 238, testimony of Government Director James Wilson.

⁵² *Ibid.*, Pt. 2, p. 17.

which they might discover. The contract bound the railroad company to buy its coal of the contractors for a period of fifteen years, at the following rates:

\$6	a ton	for the	first	two	years
\$5	"	"	"	"	next three "
\$4	"	"	"	"	four "
\$3	"	"	"	"	six "

These prices were to be for coal delivered on cars at the mines. The contractors were also to be allowed a drawback, or rebate, of 25 per cent of the tariff rate on all coal shipped for private consumption.⁵³

This contract was subsequently assigned to the Wyoming Coal and Mining Company, a corporation organized in January, 1869, under the laws of Nebraska.⁵⁴ The capital stock of this corporation was fixed at \$1,000,000, of which Wardell, who became general manager of the company, took one-tenth, President Ames and five directors of the Union Pacific taking the other nine-tenths. Godfrey, it seems, retired altogether.

The price at which this Wyoming Coal Company was to furnish coal to the railroad was exorbitant. The cost of mining this coal about the time the road was completed, and for some years thereafter, was not much over \$2 a ton. During the second half of the following decade, the average cost was reduced to about \$1.10 a ton.⁵⁵ This contract therefore was another device whereby the managers of the Union Pacific arranged to divert to themselves the road's assets.

This contract with the Wyoming Coal Company was rightly criticized by the government directors of the Union Pacific in their annual reports. The contract remained in force for several years after the road's completion. In 1874, when new interests which had no interest in this contract, had entered into the control of the railroad company, the arrange-

⁵³ For a copy of this contract see House Exec. Docs. No. 95, 43rd Cong., 1st sess. (serial No. 1607), p. 3, being the report of the government directors of the Union Pacific Railroad Company for 1872.

⁵⁴ An account of the history of this company is given in the opinion of Mr. Justice Field, in *Wardell v. Union Pacific Railroad Company*, 103, U. S. 651; 26 L. Ed. 509.

⁵⁵ Annual Reports of the Union Pacific Railroad.

ment was terminated, and the coal lands were taken possession of by the Union Pacific. Protracted litigation followed, Wardell attempting to compel the railroad to continue under the contract. The matter was finally, in 1880, decided against Wardell by the United States Supreme Court.⁵⁶

Profits of the Builders

The profits made out of the Hoxie, Ames, and Davis contracts have been variously estimated. The testimony of the interested parties is somewhat confusing, and if any records were made of these matters, they were carelessly or incompletely kept; so that anything like an accurate statement is impossible. In 1873, a congressional committee charged with investigating Union Pacific Railroad affairs reported thus:⁵⁷

	COST TO		
	COST TO R. R.	CONTRACTORS	PROFIT
Hoxie contract....	\$12,974,416.24	\$ 7,806,183.33	\$ 5,168,232.91
Ames contract....	57,140,102.94	27,285,141.99	29,854,960.95
Davis contract....	23,431,768.10	15,629,633.62	7,802,134.48
Total.....	\$93,546,287.28	\$50,720,958.94	\$42,825,328.34

Another method of computation gives the following estimate of the amount of water in the company's capitalization:⁵⁸

Government bonds on 1,038.68 miles.....	\$ 27,266,512
First mortgage bonds.....	27,213,000
Land-grant bonds.....	10,400,000
Income bonds*.....	9,335,000
Capital stock.....	36,762,300
Total capitalization.....	\$110,996,812
Actual cost, including equipment†.....	60,467,641
Fictitious capital.....	\$ 50,529,171

* These income bonds were, it appears, issued to purchase rolling stock and equipment and were not included among the Credit Mobilier's profits. (Wilson Report, p. 27, testimony of Oakes Ames.)

† Oakes Ames estimates the cost at \$60,000,000. (Wilson Report, p. 25.)

⁵⁶ *Wardell v. Union Pacific Railroad Company*, 103 U. S. 651; 26 L. Ed. 509.

⁵⁷ Wilson Report, p. XIV.

⁵⁸ White, *History of the Union Pacific Railway*, pp. 35-36; the figures are compiled from the testimony of Benjamin F. Ham, the treasurer of the Credit Mobilier. (Wilson Report, pp. 371 ff.)

It appears from the report of the same committee that the government bonds and company first mortgage bonds together furnished sufficient cash to pay for the cost of construction. If this is true all of the land grant bonds and the stock represented watered capital, as the following estimate indicates clearly:⁵⁹

Net proceeds from the sale of \$27,236,512, par value, of government bonds.....	\$27,145,163.28
Net proceeds from the sale of \$27,213,000, par value, of first mortgage bonds.....	23,718,008.77
<hr/>	
Net proceeds from both classes of bonds.....	\$50,863,172.05
Cost of road as shown by books, not including rolling stock bought with income bonds.....	50,720,958.94
<hr/>	
Surplus	\$ 142,213.11
Capital stock.....	36,762,300.00
Land-grant bonds	10,400,000.00
<hr/>	
Total amount of securities in excess of cost.....	\$47,304,513.11

Estimates of the profits measured in Union Pacific securities vary therefore from 42 to nearly 50 millions of dollars. The Credit Mobilier people placed emphasis upon the assertion that as these securities had a relatively low market value, estimates like those given above are much in excess of their immediate cash profits. In 1869 and for several years thereafter Union Pacific stock fluctuated in the neighborhood of 30. The company's bonds sold at various prices, often at a considerable discount. To be sure, no matter at how great a discount Union Pacific bonds might be quoted, their face value represented an obligation for which the company would be liable at maturity. In the meantime the road was under the necessity of meeting the annual interest upon their face,

⁵⁹ Wilson Report, p. XVII. The income bonds have been omitted from this table. Although the testimony is somewhat uncertain, it seems that these income bonds were actually used for the purpose of purchasing equipment. The issue was floated at a large discount, even as high as 50 per cent in the case of some of the bonds.

not upon their market value.⁶⁰ The following statement compiled from the testimony of Benjamin F. Ham, the treasurer of the Credit Mobilier, is an estimate of the cash profits of the contractors, measured by the approximate market value of Union Pacific securities.⁶¹

The profits on the Hoxie contract, including \$1,104,000 for work done under the Boomer contract and later included in the accounts of the Hoxie contract, were \$6,272,232.71, in Union Pacific securities.

Of this amount of securities the profits would be :

\$1,125,000 first mortgage bonds at 85.....	\$ 965,250.00
5,147,232.71 of stock at 30.....	1,544,169.81
The profits under the Ames and Davis contracts were :	
Bonds, cash value.....	11,310,900.00
\$24,000,000 of stock at 30.....	7,200,000.00
Cash	2,346,195.00

Total cash profit, approximately.....\$23,366,514.81

It would be unfair, however, not to call attention to a few of the obstacles which stood in the way of the builders of the first Pacific railroad. In view of the generous aid which the federal government gave to the Union Pacific, whatever justification exists for this method of financing the construction must rest, not upon the fact that other roads were built in the same way, but upon the difficulties, financial and otherwise, which threatened to interfere with the road's completion. The conditions along the line of the road will be considered in the next chapter. When the work commenced, labor and materials commanded high prices, owing to the war; and after the war ended, prices remained high, owing to the fact that greenbacks, not gold, formed the circulating medium. The promoters had difficulty at times in selling the company's bonds,

⁶⁰ Gold commanded a premium during this period. Interest on the first mortgage was at the rate of 6 per cent, on the land grant bonds at the rate of 7, and on the income bonds at the rate of 10 per cent.

⁶¹ Wilson Report, p. XV. See also, for further figures and further discussion of this subject of the profits made, White, *The Union Pacific Railway*; and Davis, *The Union Pacific Railway*.

owing to a universal feeling that financially the road might be a failure.

The Fisk "Raid"

One event of this period stands out prominently. This was the famous "Fisk raid," which at one time threatened to involve the whole project in ruin. The circumstances of this extraordinary incident appear to have been as follows. The notorious James Fisk, Jr., a prominent and unscrupulous speculator of the period, made a demand upon the Union Pacific Railroad Company to pay him \$75,000 blackmail; he threatened in case of refusal to bring a suit against the Union Pacific in the court of Judge Barnard, of New York.⁶² The Union Pacific people had good reason to fear a suit of this character, for Judge Barnard was thoroughly unscrupulous, and was at the time assisting Fisk and his associate, Jay Gould, in their well-known raid on the Erie Railway. Fisk's demand was nevertheless refused. Thereupon he filed a complaint in Judge Barnard's court,⁶³ in which he alleged that he had in September, 1867, offered to subscribe to 20,000 shares of Union Pacific stock, for which he had tendered a sum sufficient to meet the requirements of the law; and that the treasurer of the company had refused his tender, contrary to a charter provision which required books to remain open for stock subscriptions until the road was completed. Fisk further alleged that he was the owner of six shares of Union Pacific stock which he had purchased in the open market, and that his interests as a shareholder were being injuriously affected by construction contracts which were made with the Credit Mobilier. Fisk asked the court to order the delivery to him of the 20,000 shares of stock to which he claimed he was entitled;

⁶² Testimony taken by the Judiciary Committee of the New York Assembly in regard to Judges Cardoza and Barnard, p. 953, testimony of Cornelius Bushnell.

⁶³ Proceedings in the Trial of Judge Barnard, pp. 932 ff. It seems that the Union Pacific did pay over to some attorneys \$50,000 for the purpose of settling this suit. What became of this sum is doubtful. One story was that the money was paid to Fisk, and that Fisk "went back" on the Union Pacific. (See Wilson Report, p. 295, testimony of Oliver Ames; p. 317, testimony of John B. Alley.)

and also to issue an injunction restraining the railroad company from any further transactions with the Credit Mobilier.

This suit was brought in July, 1868, and was continued from time to time until the following March. On the ninth of that month Judge Barnard refused a motion of the defendant Union Pacific Railroad for removal to the federal court. The same day Fisk filed a supplemental complaint, asking for an injunction to prevent the railroad company from electing a board of directors at the annual meeting which was to take place on the following day. Fisk alleged, as his reason for asking for this injunction, the refusal of the company's officers to permit him to vote the 20,000 shares of stock of which he claimed he was rightfully the owner.⁶⁴ Barnard granted the desired injunction. The election was about to be held when the appearance of the sheriff at the company's office prevented it. A few days later, Judge Barnard on Fisk's application enjoined the Union Pacific from issuing any more bonds or transacting any business; and at the same time, also on Fisk's application, appointed William M. Tweed, Jr., "Boss" Tweed's son, as receiver for the Credit Mobilier.⁶⁵

These orders were ostensibly for the purpose of preventing any further alleged fraudulent relations between the railroad company and the construction company; however, if they were carried out, their effect would be to tie up work on the railroad. At that time work out on the line of the road was being vigorously carried on. If the company could not continue to raise money by selling or pledging its securities, the cash necessary to carry on the construction could not be procured.

The officers of the railroad disregarded Judge Barnard's orders and continued to transact business as usual. The Judge thereupon directed the sheriff to seize the company's offices. One of the government commissioners appointed to

⁶⁴ Proceedings in the trial of Judge Barnard, pp. 947, 948.

⁶⁵ *Ibid.*, p. 967.

examine the road learned of this proceeding and notified the railroad officials before the Judge's order could be carried out. Deciding that New York was not a safe place for them, the railroad officials gathered up the company's bonds and other things of value and fled hurriedly across the river into New Jersey. They had barely left their offices when the sheriff's posse appeared and took possession. The company's safe was broken open, but nothing of value was found within, for the auditor and his clerks had carried everything they could lay their hands on away with them out of Judge Barnard's jurisdiction.⁶⁶ Over \$400,000 of government bonds and company first mortgage bonds disappeared, however, in the confusion and were never afterwards found.⁶⁷

The company never again established its principal offices in New York. Its officers applied to Congress for permission to remove their headquarters; and upon the passage, in 1869, of an act which authorized the Union Pacific to establish its principal office in any city of the United States, the company moved to Boston.

The six shares of which Fisk was the owner had been purchased subject to the terms of the Oakes Ames contract and its assignment. Fisk pretended that it was his purpose to protect his interest as a stockholder by preventing the Union Pacific directors from making iniquitous and corrupt contracts with themselves through the Credit Mobilier arrangement. His charges were merely pretexts. Fisk had achieved notoriety in connection with the famous "Erie raid," and the New York gold conspiracy of September, 1869, which culminated in "Black Friday." His purpose in bringing suit against the Union Pacific was to reduce the price of its securities and to ruin the road's credit in order that he might get control of the company. The timely warning which the Union Pacific officials received had enabled them to remove

⁶⁶ Testimony before the Judiciary Committee, p. 955, testimony of Bushnell.

⁶⁷ *Ibid.*, p. 957, testimony of Bushnell.

themselves and the property of the company beyond Fisk's reach; but the suit and the injunctions, the raid, and the appointment of Tweed as receiver, are said to have been responsible for a decline in the market value of Union Pacific first mortgage bonds from 102 to 65.⁶⁸

One of the Union Pacific directors, Cornelius Bushnell, subsequently testified that although Fisk failed to get control of the road, this raid cost the Union Pacific about \$5,000,000 through the depreciation of its securities.⁶⁹ Mr. Bushnell testified in 1873:

Fisk had told us, "I will break you up so that you can not meet your obligations, and the first one you default on I will buy up, and so on, until I get control of the road the same as with the Erie." He bragged that he would do that.⁷⁰

Judge Barnard was one of the notoriously corrupt judges who flourished during the Tweed régime in New York. Fisk's whole record, as well as the evidence brought out in 1872 during Judge Barnard's subsequent impeachment, showed that the purpose of these proceedings was solely to enable Fisk by a "blackmailing suit" to obtain control of the Union Pacific, as he succeeded in doing in the case of the Erie.

Criticism of the Credit Mobilier Arrangement

The Credit Mobilier scheme was by no means a novel arrangement, as some have supposed. The method of building railroads from the proceeds of the bonds, and issuing the stock as a gratuity, had been the usual custom of railroad promoters. Every one of the Pacific railroads was built in the same way. Much has been said and written regarding the Credit Mobilier. This sort of financiering has been justly condemned. However, it should not be forgotten that it was a tremendous undertaking to construct a railroad through an uninhabited region, over mountains, and in a desert where water was scarce and

⁶⁸ Testimony taken by the Judiciary Committee, p. 955, testimony of Bushnell.

⁶⁹ *Ibid.*, p. 956, testimony of Bushnell.

⁷⁰ Wilson Report, p. 48, testimony of Bushnell.

Indians a constant danger; with labor high, with gold at a premium, and materials for construction abnormally expensive. There is little likelihood that the road could have been built under the stock subscription plan contemplated by the acts of Congress. It must be conceded that men who take extraordinary risks have a right to large returns. The men who were interested in the Credit Mobilier were apparently unconscious of the existence of anything in the nature of fraud in the construction contracts, and they asserted that so far as the road's management was concerned, it was the business of no one except themselves. The testimony of John M. S. Williams illustrates their attitude:

Q. Do you think it was acting in good faith to the Government to include in the cost of the road the profits which they divided up among themselves?

A. I do not think the Government was interested in it at all and therefore do you see any want of good faith at all. . . . In everything we did we thought nobody had any interest but ourselves.⁷¹

Mr. Williams also testified as follows:

Q. Did this road cost the Union Pacific Railroad Company more than it cost the Credit Mobilier?

A. It depends upon how you look at it. If your right-hand pocket had more money than your left, and you took some from your right and put it in your left, you would be neither richer nor poorer.⁷²

On the other hand, Congress and the nation had placed a great trust in the hands of the men who were to build the Pacific railroad. The government had made an unconditional grant of land which proved to be worth millions of dollars. In addition, the government loaned to the company over \$27,000,000 of subsidy bonds. The bond subsidy furnished over half the sum needed to build the road. The road's entire capitalization was nearly double what it had cost to build and

⁷¹ Wilson Report, p. 167, testimony of J. M. S. Williams.

⁷² *Ibid.*, p. 170, testimony of J. M. S. Williams.

equip the Union Pacific. The interests of the government, of future security-holders, and of the public, who would be forced to bear the burden of the company's inflated capitalization, were disregarded.

One other matter remains to be considered. The builders asserted that their entire cash profits could not be called excessive as they did not exceed the cost of construction by more than about 25 per cent. Construction companies which built railroads in the settled parts of the country where there was much less risk frequently made as much, it seems, as 100 per cent.⁷³ Even if this last statement is true, the inference is somewhat misleading. The actual construction cost between \$50,000,000 and \$60,000,000, but these men did not raise this sum out of their own pockets. Had they done so, it might be conceded that their claim to a profit of 25 per cent was reasonable, in view of the risks which they ran. The entire capital stock of the Credit Mobilier, which represented their original cash outlay, amounted to only \$3,750,000. As the work progressed funds were obtained from the sale of government bonds and the railroad company's securities. One authority estimates the amount of capital invested at any one time as probably not in excess of \$10,000,000;⁷⁴ so that if this figure is approximately correct the contractors made a profit of over 200 per cent. This fact should be borne in mind as having an important bearing upon the reasonableness of the contractors' profits.

It is much easier to point out the evils of the Credit Mobilier scheme than it is to point out how the road could have been built in any other way. General Dodge has said that when he suggested to President Lincoln that the government build the Pacific railroad, the President refused to entertain any such project. In 1862 the United States was engaged

⁷³ Wilson Report, p. 435, testimony of Horace A. Clark.

⁷⁴ Davis, *The Union Pacific Railway*, p. 172. White in his work on the Union Pacific fails to take this into account. According to his figures the profits of the contractors were about \$16,000,000. "This," he says, "does not seem an immoderate profit." *History of the Union Pacific Railway*, p. 37.)

in the Civil War and so was too much occupied to enter the field of railroad construction. Lincoln was ready to offer ample governmental aid, but he insisted that private capitalists do the work. If the government had undertaken to build the Pacific railroad, it would have done so at a time when corruption permeated the national Civil Service, when fortunes were being made by corrupt army contractors, when "carpet-baggers" flourished, when frauds in the Indian and in the postal service were just beginning to reach enormous proportions, when the judiciary of the great city of New York, the financial center of the nation, was at the service of men like Fisk and Tweed, and when dishonesty affected many branches of the federal government. It is not improbable that a government-built road might have developed far greater abuses than the Credit Mobilier.

What other course might have been adopted, and with what result, is conjectural. A frank offer to capitalists of a cash bonus, or an unconditional bond subsidy, paid in instalments, with proper supervision upon the road's capitalization to prevent any stock or bond watering, might have accomplished the desired result. The road certainly was worth a large bonus, both to the government and to the people. If such a course could have been found practicable, it might have avoided the overcapitalization which levied a tax upon the future of the Union Pacific and upon the general community.

In 1873, during the course of a congressional investigation, Horace A. Clark, who was at that time president of the Union Pacific, was asked if the company's financial condition would not have been vastly improved if its capital stock had been originally paid in in cash, and the road built with the proceeds. Mr. Clark had not been in any way connected with the Credit Mobilier; yet his answer is an interesting commentary on the road's early history:

Taking into consideration the high prices of the times, the reckless extravagance of the construction, the fact that it

was a road built in the first place without a route, no pass then discovered, . . . without timber, without fuel, without water, with gold, I think, at 160 and with iron at \$160 a ton, the work hurried up with night and day gangs, working with great rapidity in order to get the advances from the Government, with half the force engaged in keeping the Indians off from the other half that was at work; if there had been thirty millions at that time in the treasury, I think the money would have been very soon squandered, and I do not believe that there would have been a road.⁷⁵

President Clark's judgment may have been wrong; his opinion is nevertheless interesting and his argument plausible. The weight of evidence seems to indicate: that the builders saw no impropriety in their policy; that they built a fairly good road for that time; and that they prosecuted the work of construction with vigor and energy. But when the road was finished, on May 10, 1869, it was encumbered with a bond issue of more than \$74,000,000, par value, in addition to the capital stock. Upon the funded debt the annual interest was very heavy. The stock was not worth more than about 30 cents on the dollar. The entire capitalization of the Union Pacific amounted to \$110,962,812, or over \$106,000 a mile, of which nearly 50 per cent was water.

⁷⁵ Wilson Report, p. 403, testimony of H. A. Clark.

CHAPTER III

THE WORK OF CONSTRUCTION

Character of Country

The Credit Mobilier will be further and more fully discussed in the following chapter. No just verdict regarding the Credit Mobilier operations can be rendered without a proper appreciation of the physical conditions under which the Union Pacific was built. While the Credit Mobilier scheme has received general condemnation, fairness to the builders of the first transcontinental railroad demands a presentation of a picture of the situation which confronted them out on the line of the road. It must be understood that the large capitalization of the Union Pacific was not entirely a result of the Credit Mobilier transactions. Other causes contributed to make this road more costly than its more recently built competitors.

Before this railroad was built, the only settlements in the far west outside of California and Oregon were a few mining camps in Colorado and in Nevada, and the Mormon colony in the valley of Great Salt Lake. Between the Missouri River and California the country intervening was almost entirely uninhabited save by the Indians. On maps drawn at that time, what is now the great agricultural state of Nebraska was indicated as a part of the "Great American Desert." In Wyoming, Utah, and Nevada, water was scarce, and where it was found it was heavily impregnated with alkali. In this region the land along the line of the proposed overland road was known to be desert land. Much of the territory which was formerly known as the "Great American Desert" has since been found suitable for agriculture or grazing, and valuable mines, not only of gold and silver, but of coal and iron, have been

developed; but at that time the physical characteristics of this region held out very little promise of developing local traffic.

When construction began on the Union Pacific, railroads were building west through Iowa, but Omaha was without through railroad connection with the east until 1867. Materials, machinery, and laborers were forced to ascend the Missouri River in steamboats or travel overland in wagons. The Union Pacific was building across a timberless prairie; the few trees which were found along the route were mostly cottonwoods, which required burnetizing before they could be used for ties. It is said that on a portion of the road the ties cost as much as \$5 apiece.¹ Under the law the company was compelled to use American iron for its rails and equipment. This restriction is said to have increased the cost of the iron used by about \$10 a ton.² While building through the desert, water was shipped out over the track already laid, and was hauled from the end of the rails to the places where the men were working.³ The Indian inhabitants of the plains contributed their share to the difficulties of building the road.

Private surveys, not the Pacific railroad surveys which were made under the direction of the United States government in 1853, determined where the road was to be located. Surveys continued almost until the road's final completion. Work on the eastern portion of the line, in Nebraska, was completed and the track laid before the route farther west had been located definitely. Each surveying party included the usual number of civil engineers, rodmen, flagmen, and chainmen, besides axemen, teamsters, and herders. When a party was expected to live on game a hunter was added. Each party numbered from 18 to 21 men, all of whom were well armed. In the Indian country the men were regularly drilled, although after the Civil War was over this was generally

¹ Poland Report, p. 108, testimony of Alley. This is denied by a subcontractor who furnished ties for a part of the route. He says ties cost only 60 or 70 cents each. But this part was in the Wahsatch Mountains, near a timber supply. (See Pac. Ry. Com., testimony, p. 1087, testimony of J. W. Davis.)

² *Ibid.*, p. 255, testimony of James Brooks.

³ Wilson Report, p. 694, testimony of A. J. Poppleton.

unnecessary, as a large number of discharged soldiers entered the employ of the Union Pacific. Surveyors operating in a hostile country were usually accompanied by detachments of United States troops; but notwithstanding this protection, parties were often attacked, their men killed or wounded, and their livestock run off.⁴

The Evans Pass

In 1866, General Granville M. Dodge became chief engineer. At this time the problem of locating a pass over the range had not yet been solved. The adoption of a line through Denver would force the road to cross the mountains by one of the high passes of Colorado. Surveys of these passes showed that their elevations were so great that many of them crossed the range near the snow line. A railroad through Colorado would require difficult and expensive engineering. A much easier route lay through Wyoming. Where the Continental Divide is crossed by the Union Pacific, west of Rawlins, Wyoming, it is a gently sloping plateau. The only serious difficulty by way of this route was just west of Cheyenne, where there is a sharp ridge known as the Black Hills, or Laramie Mountains.

General Dodge believed he had found the true location over this range in 1865, the year before he became chief engineer. The discovery by him of the Evans Pass affords an illustration of the Indian danger to which surveying parties were constantly exposed. In 1865, while the General was still in the service of the United States army, he was returning from an Indian campaign in northeastern Wyoming. His great interest in the Pacific railroad project led him to leave his troops from time to time for the purpose of examining the approaches and passes of the Black Hills south of Fort Laramie, Wyoming. On these occasions he was accompanied only by small detachments. When his main body of troops reached Lodge

⁴ Dodge, *How We Built the Union Pacific Railway*, p. 13.

Pole Creek, in southeastern Wyoming, Dodge took six men with him and rode up the creek to the summit of the Cheyenne Pass. From this point the party rode southward along the crest of the range. Without warning a band of Indians appeared between them and the main body of their troops. General Dodge's party managed in some way to reach a nearby ridge on the eastern slope, where they could signal to the main body. Then dismounting, they started down the ridge. They succeeded in holding the Indians at bay with their rifles until their cavalry, having seen their signals, came to their relief.⁵ On this occasion Dodge followed this ridge and found that it led without a break to the plains. He also observed that the geological character of this pass was of such sort that it would greatly facilitate the work of building a railroad over it. Later and more detailed surveys made after Dodge became chief engineer demonstrated that this pass was the most suitable route for a railroad.

It was the discovery of this pass which enabled the contractors to save a large sum in building over the range. The physical difficulties anticipated in building over the mountains were greatly simplified. James Wilson, a government director, testified in 1873:

From my knowledge of the line now and of the country through which it passes, I think that if Congress had understood what can be seen in that country now, the act of 1864 would not have been passed in its present terms. . . . It looks very different now going through the country by rail, from what it did by the reports that came to us as to the condition of the country, its character, formation, etc.⁶

Indian Difficulties

But if the anticipated physical difficulties to be met in the mountains proved to have been exaggerated, the builders had

⁵ For a full account of this incident, see Dodge, *How We Built the Union Pacific Railway*, pp. 17 ff.; also Wilson Report, p. 238, testimony of James Wilson. This pass is near the Sherman station, a few miles west of Cheyenne, Wyoming.

⁶ Wilson Report, p. 238, testimony of James Wilson.

no lack of trouble at the hands of hostile Indians. General Dodge has told of the experiences of surveying parties in the Indian country. Near the present site of the city of Cheyenne, one party was attacked and two men killed.⁷ Another party working near the east base of the mountains was driven off and its chief killed.⁸ In 1867 a party surveying on the Laramie Plains, west of the Black Hills, lost several men in a fight with the Indians near what is now the Cooper Lake station. This party lost some of their animals and supplies as well. Nevertheless the same party continued its surveys westward into what is known as the Red Desert, in the south central part of the territory of Wyoming. A detachment working near Bitter Creek was again attacked by Indians and Percy T. Browne, the chief of the party, was killed.⁹ General Dodge relates other occasions when surveying parties were robbed and their men killed. These Indian difficulties added materially to the cost of surveying.

The official reports of the chief engineer call attention to the difficulty of obtaining water, and the hardship which surveying parties underwent on this account. On one of his surveys in western Wyoming, General Dodge himself rescued a party which was in great distress on account of lack of water.¹⁰ It was found necessary to sink deep artesian wells in order to obtain water not only for the men but for locomotives. Where surface water was found it was usually so impregnated with alkali as to be unfit for use in locomotives.¹¹ Good water was particularly scarce in the region between Rawlins, Wyoming, and Green River, Wyoming, a distance of about 130 miles.

While construction on the first 500 miles on the open level plains was not difficult after the necessary material had been hauled out to the end of the track, or the "front," hostile

⁷ Dodge, *How We Built the Union Pacific Railway*, p. 19.

⁸ *Ibid.*, p. 20.

⁹ *Ibid.*, Report of the Chief Engineer for 1868, pp. 33 ff.

¹⁰ Dodge, *How We Built the Union Pacific Railway*, p. 21.

¹¹ Report of the Chief Engineer for 1868-9, p. 4.

Indian bands frequently interrupted the work. Nearly all the men employed on the road were Civil War veterans, and while they were at work their arms were stacked near at hand, ready for instant use. At times half of the force would stand guard while the other half worked.¹² It was frequently necessary to ask assistance of the troops stationed at Fort Kearney. From Fort Kearney to Bitter Creek, a station far out in Wyoming, every mile had to be surveyed, graded, tied, and bridged under military protection.¹³ Notwithstanding all precautions, it is said that hundreds of workmen were killed and much of the livestock lost.¹⁴ On one occasion the government commissioners, whose business was to examine and report upon a portion of the road in central Nebraska, had the opportunity of witnessing a battle which occurred about a mile from the end of the track. Surveyors' stakes were pulled up and destroyed, stations were raided, and construction trains wrecked. Says General Dodge:

Troops guarded us and we reconnoitered, surveyed, located and built inside of their picket lines. We marched to work to the tap of the drums with our men armed. They stacked their arms on the dump and were ready at a moment's warning to fall in and fight for their territory.¹⁵

Conditions Attending Construction

There were other difficulties as well. Although the discovery of the Evans Pass greatly simplified the problem of building over the Black Hills, it must not be imagined that all physical obstacles were removed. In crossing this range it required skilful engineering to keep within the maximum grade of 90 feet to the mile. Just west of the Sherman station, the highest point on the line, it was necessary to bridge Dale Creek, a chasm between 600 and 700 feet wide and over 130

¹² Wilson Report, p. 431, testimony of H. A. Clark.

¹³ Dodge, *How We Built the Union Pacific Railway*, p. 15.

¹⁴ *Ibid.*, p. 15. See also Wilson Report, p. 494, testimony of John Duff.

¹⁵ Dodge, Paper on Transcontinental Railways, read before the Society of the Army of the Tennessee, at Toledo, Sept. 15, 1888.

feet high. Material for this bridge was hauled out ahead of the track. According to one statement this bridge cost ten times as much to build as it would have cost had it been built five years later.¹⁶ From Dale Creek down to the Laramie Plains, in Wyoming, much of the work was through solid rock.

From the Laramie Plains till the valley of the Green River was comparatively an easy road to build. . . . Then we came to the Green River which was a very costly and expensive place to build a road, and we came out to the Carbon and got to the coal fields and down to Butte Creek¹⁷ where it was impossible for the cattle to drink the water without dying. There was no vegetation there. Every particle of corn and hay and grain for the cattle, and food for the men, had to be carried ahead 200 or 300 miles, where the men were doing the grading. A pound of corn brought there cost perhaps twenty times as much as it cost where it started from. All this made the construction mighty expensive.¹⁸

It was often necessary to haul water in trains to the end of the track and then to carry it, sometimes 50 or 60 miles, to the "front" in wagons; provisions and supplies were carried from the end of the track by mule teams at a cost, it is said, of \$25 a day for each team.¹⁹

Advance parties of surveyors, who located the route, were followed by the graders. They could grade about 100 miles in thirty days where it was level. The men who graded the portions farther west did their work several hundred miles in advance of the track-layers. Bridge gangs worked from 5 to 25 miles ahead of the track. To supply one mile of track required 40 cars. At one time from 8,000 to 10,000 laborers were at work on the road in addition to 10,000 animals. Rails, ties, bridging, fastenings, railway supplies, fuel for locomotives and trains, and supplies for men and animals, were all trans-

¹⁶ Wilson Report, p. 45, testimony of Bushnell. This estimate is doubtless an exaggeration.

¹⁷ This must be a mistake. Bitter Creek is probably meant.

¹⁸ Wilson Report, p. 45, testimony of Bushnell.

¹⁹ *Ibid.*, p. 694, testimony of A. J. Poppleton. See also Speech of Oakes Ames in the House of Representatives. (Cong. Globe, 42nd Cong., 3rd sess., p. 1723.)

ported over this single track line west from the Missouri River.²⁰

As the rails moved farther and farther west, towns which had come into existence overnight near the end of the track were either partially or entirely deserted. Each of these so-called "terminal towns" was a collection of tents and easily constructed portable houses. Each one was expected by its friends to become the "great city of the west," until the terminus of the road moved farther west. The inhabitants, aside from the men who were employed on the railroad, consisted largely of the lawless, floating class that has always accompanied American westward expansion. A large portion were desperadoes, gamblers, and abandoned women. The debauchery and crime which flourished in these temporary camps suggested to an eastern editor the appropriate name of "Hell-on-Wheels." In some instances, permanent, law-abiding settlements developed after the floating population had moved farther west. North Platte, Julesburg, Cheyenne, and Laramie are among the places where "Hell-on-Wheels" paused in its westward march.²¹

Excessive Speed of Construction

Such were the general conditions attending the building of the Union Pacific Railroad. No mention has yet been made of one other important factor which swelled the cost of construction—the speed with which the road was built. There existed a nation-wide demand that the road be finished as soon as possible, and in addition the financial interest of the promoters impelled them to hasten the work. After the passage of the act of 1866, which authorized the Central Pacific to build east until it met the Union Pacific building west, both roads began a race across the continent for the

²⁰ Dodge, *How We Built the Union Pacific Railway*, pp. 13, 14, 15.

²¹ For pictures of the conditions in these "terminal towns" see Paxson, *The Last American Frontier*, pp. 131-34; and J. H. Beadle, *The Undeveloped West, or Five Years in the Territories*, Philadelphia, Chicago, Cincinnati, and St. Louis, 1873, pp. 87 ff.

possession of the tempting subsidies which each additional mile would bring to them. There was added a desire on the part of each road to control the traffic of the valley of Great Salt Lake, where were the only local settlements of any consequence along the entire route. Rich coal mines which had been discovered in Wyoming would likewise be the prize of the road which first reached them. In their struggles to outdo each other, the men in control of the two companies hesitated at no expense. Speed, not economy, was the object. The Oakes Ames contract contained a clause declaring that its essence was speed of construction and time of completion. The army of men out in the western deserts laid more miles of track each day than the history of railroad building had ever known before. During 1867 and 1868 the Union Pacific at times laid as much as from 4 to 7 miles of track daily.

The road from Julesburg, Colorado, to Green River, Wyoming, a distance of about 450 miles, was constructed during 1867 and 1868. In 1868 cold weather caught the builders in the Wahsatch Mountains; nevertheless winter was not allowed to delay the work. Grading and track-laying went right ahead on the snow and ice.²² Sometimes temporary tracks were laid upon the snow.²³ General Dodge relates that one time he saw a construction train slide, locomotive, track, and all, off the embankment into the ditch.²⁴ Work on the cuts and tunnels was carried on at a time when the earth was frozen into a solid mass. It was necessary for the men to wear heavy overcoats while they worked. Track-laying which should have cost \$600 per mile is said to have cost \$1,500 per mile.²⁵

According to General Dodge, building over the Wahsatch Range in winter added \$10,000,000 to the road's cost.²⁶ In one of his official reports to the company he says that the

²² Dodge, *How We Built the Union Pacific Railway*, p. 23.

²³ Poland Report, p. 255, testimony of James Brooks.

²⁴ Pac. Ry. Com., testimony, p. 3807, testimony of Gen. Dodge.

²⁵ Wilson Report, p. 510, testimony of Sidney Dillon.

²⁶ Dodge, *How We Built the Union Pacific Railway*, p. 23.

cost was doubled, and sometimes even trebled and quadrupled, by reason of the difficulties which necessarily attended construction during the winter months. He adds further:

The extra cost of doing this portion of the road is accounted for by these untoward circumstances under which it was pressed forward to completion, and it is not due to any large amount of work required per mile, or peculiarities in its location, or to anything pertaining to this immediate locality, or to its mountainous character. . . . None of us have ever approached a just estimate of the real expense and difficulty of prosecuting work in high altitudes during the winter season, and I am led to doubt whether anything is really gained in time, distance accomplished, or future advantages secured, to compensate for the enormous cost of such efforts.²⁷

In their mad race, the two companies graded about 200 miles side by side, in Utah and eastern Nevada, the Central Pacific grading east, the Union Pacific grading west. The Union Pacific wasted many thousands of dollars in employing men to work as far west as Humboldt, in central Nevada. The Central Pacific had graded its line to Echo Cañon, in the Wahsatch Mountains, in eastern Utah. Between Ogden and Promontory, Utah, a distance of about 50 miles, graders of the rival railroads worked alongside of one another at the same time, and trouble sometimes arose between the Irish laborers working for the Union Pacific and the Chinese coolies employed by the Central Pacific.²⁸

The dispute between the two companies threatened at one time to become serious enough to prevent a junction. Congress finally intervened, and on April 10, 1869, passed a joint resolution which fixed Promontory, Utah, as the place where the two roads were to meet.²⁹

Here the tracks met a month later, on May 10, 1869. The

²⁷ Report of the Chief Engineer for 1868-9, p. 8.

²⁸ Dodge, *How We Built the Union Pacific Railway*, p. 24.

²⁹ 16 Stat. L. 56. The portion of the line between Promontory and a point 5 miles west of Ogden was sold to the Central Pacific, and the 5 miles immediately west from Ogden were leased by the Central Pacific from the Union Pacific. Thus Ogden became the common terminus.



Driving the Last Spike—Union Pacific and Central Pacific Railroads.
May, 1869, Promontory, Utah

Furnished by the Passenger Department of the Union Pacific System



entire nation turned its attention to this great event. A great number of people assembled out on the desert to watch the joining of the rails. The last tie, of polished California laurel, bore a silver plate on which was this inscription:

THE LAST TIE
LAID IN THE COMPLETION OF THE PACIFIC
RAILROAD, MAY 10, 1869.

After the tie had been laid in place, Leland Stanford, the then president of the Central Pacific, drove the last spike, which was of California gold, while telegraph wires received the taps of the hammer and transmitted them all over the country. The Pacific was now joined to the Atlantic, and the nation was united.³⁰

Political Interference During Construction Period

While the work was still in progress, reports circulated to the effect that the line was being lengthened unnecessarily in order that greater subsidies might be obtained. This charge was too broad, although it was well founded in one or two instances. West of Omaha the directors, after spending a considerable sum in grading, abandoned the original location which Engineer Dey had made, and adopted a more circuitous route somewhat to the south whereby the road was lengthened 9 miles in a distance of 13 miles. The directors made this change ostensibly for the purpose of reducing the grade over a range of hills just west of Omaha.³¹ While in fact no such reduction resulted,³² the government reluctantly acquiesced in this new location and issued the subsidies upon the mileage of the lengthened line. There is some ground for believing that a portion of the line in Wyoming, near Laramie, was

³⁰ Promontory, where the rails met, is no longer on the through line. The new route across Great Salt Lake goes somewhat to the south of the old line. The station of Promontory Point on the new cut-off is not the same as the Promontory station where the rails met.

³¹ House Exec. Docs. No. 1, 39th Cong., 1st sess. (serial No. 1248), being the annual report of the Secretary of the Interior, pp. 891 ff., especially p. 898.

³² Dodge, *How We Built the Union Pacific Railway*, p. 12; according to Gen. Dodge, the acceptance of this route was in direct violation of the law.

also lengthened for the same reason,³³ but there is no evidence to indicate that this was done anywhere else. After 1898 a corps of modern engineers went over the Union Pacific for the purpose of rebuilding the road and improving its physical condition. These engineers made certain costly changes and grade reductions which were only warranted by the large volume of traffic; but they made comparatively few alterations in the road's location. On the entire line from Omaha to Ogden the only changes of line which materially shortened the distance were made just west of Omaha and in a few places in Wyoming.³⁴

The unprecedented speed of construction lent a certain color to the charge which was not infrequently made, that the company had built a poor line, for the sole object of getting the subsidies. That the speed with which the road was built resulted in inferior work is probably true. On the other hand the testimony of the builders, of government directors and commissioners, and of disinterested third parties, such as newspaper correspondents and travelers,³⁵ is that the road was on the whole a fairly well-built road, as roads were built at that time, although there is no doubt that before the Union Pacific could be called a first-class road, much more work was necessary.

There were, however, adverse reports. Two government officers published official reports which asserted that the work had been badly done. One was made by Isaac W. Morris, a government commissioner appointed to examine and report upon a portion of the road near Ogden. How much technical

³³ Dodge, *How We Built the Union Pacific Railway*, p. 26.

³⁴ E. H. Harriman said in 1902: "An idea has generally prevailed that the length of the Pacific roads was made unnecessarily great for the purpose of getting large subsidies and grants. In our recent improvements on the Union Pacific we have expended \$6,700,000 on the Rocky Mountain division and on 392 miles of that line we constructed 158 miles of new railroad, threw away 188 miles of the old railroad and expended something like \$2,000,000 on the line between Cheyenne and Omaha. Now in that whole distance of 1,030 miles, with that expenditure, the diminution of curvature was from 10 degrees maximum to 4 degrees and the reduction of grades in the mountains from 90 feet to 43 feet, the whole distance of 1,030 miles was reduced only 30 miles." (*Commercial and Financial Chronicle*, 74:1196. 1902.)

³⁵ For a traveler's account, see Beadle, *Five Years in the West*, p. 131.

knowledge Mr. Morris had, which some claimed was necessary in order to understand railroad construction in the dry regions of the west, does not appear. He reported, on May 28, 1869, that the temptation to work fast had resulted in inferior work, that the trestle work was altogether too light, the curves too sharp, and the general appearance of the road slovenly. Embankments, he says, were not wide enough, bridges were wooden and unsafe, and the general character of the road dangerous for heavy trains.³⁶ There is no reason to believe that any improper animus prompted Morris' report. A more damaging statement was issued in March, 1869, by a government director named Snow. Snow reported that the general character of the eastern portion of the line was marked by bad curves, which saved labor and increased the mileage; that in western Wyoming the road was built right on the alkali and therefore liable to washouts; that the embankments and excavations were generally too narrow; and that the construction was characterized by carelessness and mismanagement throughout.³⁷ It is claimed that Snow's report followed a refusal on the company's part to submit to a blackmailing demand which he had made.³⁸

During the course of the debate over the joint resolution of April 10, 1869, which fixed Promontory, Utah, as the junction point of the Union Pacific and the Central Pacific, Senator Stewart of Nevada made a serious attack on the Union Pacific management. He accused the company's officers of having sacrificed safety to speed, of building the road in a careless and slovenly manner, and of a general design to defraud the government.³⁹ Stewart's assertions must, however, be taken with a liberal allowance. He was himself probably open to the charge of unfairness. He represented the

³⁶ House Exec. Docs. No. 180, 44th Cong., 1st sess. (serial No. 1691). Morris' report was confined to the portion of the line between the Wahsatch Mountains and Promontory, where the rival construction forces had graded alongside of one another.

³⁷ Sen. Exec. Docs. No. 69, 49th Cong., 1st sess. (serial No. 2336), pp. 56-64.

³⁸ Wilson Report, p. 290, testimony of Oliver Ames.

³⁹ Cong. Globe, 41st Cong., 1st sess., p. 536. During heated debates in Congress between adherents of the Union Pacific and the Central Pacific, charges of fraud were freely made by both sides.

state of Nevada, and was the Central Pacific's spokesman in the Senate.

For the purpose of investigating the truth of the various charges which circulated both in regard to the Union Pacific and the Central Pacific, Congress inserted in the joint resolution of April 10, a section providing for the appointment of a board of five "eminent citizens" whose duty was to examine and report upon the physical condition of both roads. Patents for one-half the land grant were to be withheld until the companies had complied with such recommendations as this board of "eminent citizens" might, after examining the roads, see fit to make. The names of the members of this board were Hiram Walbridge, S. M. Fenton, C. B. Comstock, E. F. Winslow, and J. F. Boyd. These men inspected the Union Pacific in 1869, and reported in October of that year that while a large amount of work yet remained to be done, the road's location was creditable, and that fewer errors had been made than might reasonably be expected.⁴⁰ They recommended that some of the trestles be filled in; but they reported that the Dale Creek bridge, which Snow's report had especially criticized as being a dangerous structure, was safe, well built, and required no filling. They reported that while the road compared favorably with a majority of the first-class roads in the United States, certain improvements should be made, such as ballasting, widening embankments, and putting up new buildings. They set forth in detail what work they considered necessary, and estimated the additional expense at \$1,586,100. The railroad company carried out their recommendations and during the next few years expended in physical improvements double the amount which their report had called for.

Had the company's managers avoided the reckless haste with which the road was built, and had they adopted a more economical policy in the matter of the construction contracts,

⁴⁰ Sen. Exec. Docs. No. 90, 41st Cong., 2nd sess. (serial No. 1406).

a large sum would doubtless have been saved, and the road's capitalization might have been correspondingly reduced. There were, however, some elements of unnecessary cost which cannot be laid to the door of these men. Mention has been made of the fact that iron cost very much more than it would have cost if the company had been permitted under its charter to purchase foreign iron. United States commissioners whose business was to examine the road for acceptance were often political appointees without technical knowledge of railroad building and operation. Their ignorance of practical civil engineering involved the company in large unnecessary expenses. On the Laramie Plains the government's representative required a cut through each rise, in order that the track might run on a level, instead of following the contour of the country. These cuts subjected the road to a very severe snow blockade in the winter of 1869-1870, and the company was forced to spend in the neighborhood of \$600,000 in order to refill the cuts and raise the tracks.⁴¹ The government commissioners also required the company to erect expensive machine shops at North Platte, Nebraska. In 1873, Horace A. Clark, the president of the road, testified that these shops had cost the company \$300,000 but were "not worth three cents."⁴²

In 1868 a government commissioner named Cornelius Wendell had been appointed to examine and report upon a portion of the road near Bryan, in western Wyoming. Before making any report whatever, he demanded that the company pay him \$25,000. As time was pressing and it was necessary to have the road accepted before the subsidies could be drawn, the company yielded to Wendell's demand and paid him the money.⁴³ It is probable that there were many other instances of like dishonest blackmailing demands. "We were plundered," says John B. Alley, "all along the line of the

⁴¹ Wilson Report, p. 432, testimony of H. A. Clark.

⁴² *Ibid.*

⁴³ *Ibid.*, pp. 467 ff., testimony of Webster Snyder; pp. 289 ff., testimony of Oliver Ames.

road by everybody, who seemed to think we were fair game."⁴⁴

The Union Pacific Railroad was the greatest work of internal improvement which up to that time had been undertaken in America. Its completion solved the Indian problem,⁴⁵ opened up the Great West, and made possible the United States of today. Its construction should have been a source of national pride; but less than four years after the last spike had been driven, when the nation applauded the daring and enterprise of the builders, the Credit Mobilier disclosures resulted in one of the most sensational legislative scandals the country has known. The Union Pacific Railroad and the Credit Mobilier became bywords, and the men who built the first Pacific railroad, and who should have enjoyed the lasting gratitude of their fellow-citizens, were held up to national reproach and shame.

⁴⁴ Wilson Report, p. 568, testimony of John B. Alley.

⁴⁵ Paxson, *The Last American Frontier*, p. 347; Paxson, *The Pacific Railroads and the Disappearance of the Frontier in America*, in Annual Report of the American Historical Association, 1907.

CHAPTER IV

CONGRESSIONAL SCANDALS: CREDIT MOBILIER; THE MULLIGAN LETTERS

Rumors of Corruption

While the road was still unfinished, reports began to circulate to the effect that the directors and stockholders of the Union Pacific Railroad were diverting, by means of some corrupt device, the road's immense subsidies and enriching themselves at the expense of the company's treasury and of the government. It was rumored that through some improper arrangement with reference to the construction contracts, an organization known as the Credit Mobilier had in some way obtained possession of the Union Pacific Railroad Company's assets. In their official reports the government directors criticized the contract prices of the Hoxie, Ames, and Davis contracts. In 1868 and 1869 James Fisk's charges attracted considerable attention to the Credit Mobilier, but Fisk's reputation was such that his charges carried little weight. In debates in Congress some members denounced the Credit Mobilier as a fraud, while others rose to its defense. Charles Francis Adams wrote in January, 1869:

Who, then, constitute the Credit Mobilier? It is but another name for the Pacific Railroad Ring. The members of it are in Congress; they are trustees for the bondholders, they are directors, they are stockholders, they are contractors; in Congress they vote the subsidies, in New York they receive them, on the plains they expend them, and in the Credit Mobilier they divide them; as stockholders they own the road, as mortgagees they have a lien upon it, as directors they contract for its construction, and as members of the Credit Mobilier they build it.¹

¹ Adams, "Railroad Inflation," North American Review, Jan., 1869.

Early in 1869 Senator Stewart, of Nevada, made a violent attack upon the Union Pacific management. In a speech in the Senate he charged the builders not only with having in their eagerness to outdo the Central Pacific built a very poor road, but with having perpetrated a gigantic fraud upon the government by means of the contracts which it made with the Credit Mobilier; and he declared that the whole management was altogether corrupt and incompetent.²

The charges which were freely made in Congress and out regarding frauds alleged to have been committed by the Credit Mobilier had one immediate effect. A section of the joint resolution passed on April 10, 1869, directed the Attorney-General to investigate whether any illegal profits or dividends had been made, as it was charged, and if so, to take steps to compel a restoration of such sums as had been improperly diverted. However, it seems no such investigation was made. In the national excitement and enthusiasm over the road's completion a month later, in May, 1869, the Credit Mobilier was lost sight of. Senator Stewart's attack on the Credit Mobilier had been made in the interest of the Central Pacific, with a view to inducing Congress to fix the junction of the two roads farther east. He and the interests he represented had nothing further to gain by pressing their attack; investigation of the Credit Mobilier might result in a disclosure of the operations of the construction company which built the Central Pacific. Therefore Stewart refrained from making any further charges. The interest in the Credit Mobilier soon waned. The country was more interested in other things. The rumors which had circulated in 1868 and 1869 were apparently forgotten.

Publication of Ames Letters

A publication in the *New York Sun* suddenly revived national interest in the Credit Mobilier. That paper, on Sep-

² Cong. Globe, 41st Cong., 1st sess., p. 536.

tember 6, 1872, printed some letters which Oakes Ames had written to Henry S. McComb, one of the seven trustees.³ These letters to McComb disclosed the existence of what appeared to be a corrupt congressional ring, whose object was to obtain governmental favors for the Union Pacific Railroad. The publication of these letters attracted wide attention. The nation was again reminded of the reports which had circulated earlier, in 1868 and 1869, regarding the enormous profits which the contractors had made out of the road's construction. It now appeared as if the men interested had not alone defrauded the government and the railroad through the means of improper construction contracts let at excessive prices; but it seemed that the promoters had had corrupt relations with members of Congress as well. From the contents of these letters, it seemed that Ames had distributed shares of Credit Mobilier among congressmen in order to influence congressional action toward the Union Pacific. Wrote Ames to McComb on January 25, 1868:

You say I must not put too much (Credit Mobilier stock) in one locality. I have assigned, as far as I have gone, to 4 from Mass., 1 from N. H., 1 Del., 1 Tenn., 1 Ohio, 2 Penn., 1 Ind., 1 Maine. I have 3 to place which I shall put where they will do the most good to us. I am here on the spot and can better judge where they should go.

Two other interesting extracts from this correspondence are as follows:

Yours of the 28th is at hand enclosing copy of letter from, or rather to, Mr. King. I don't fear any investigation here. What some of Durant's friends may do in N. Y. courts can't be counted upon with any certainty. You do not understand by your letter what I have done and am to do with my shares of stock. . . . I have used this where it will produce most good to us I think. . . . In view of King's letter and

³ See also the files of the *New York Tribune*, especially September 7, 1872. The correspondence is printed as a part of the testimony of H. S. McComb, pp. 4, 5, Poland Report.

Washburne's move⁴ here, I go in for making our bond dividend in full. We can do it with perfect safety. . . . The contract calls for the division and I say have it (January 30, 1868).

We want more friends in Congress and if a man will look into the law (and it is difficult to get them to do it unless they have an interest to do so) he can not help being convinced that we should not be interfered with (February 22, 1868).

The publication of these letters resulted, it seems, from a quarrel between Ames and McComb. McComb had been one of the earlier promoters, and a partisan of Durant in the internal disagreements of the Union Pacific management. The Credit Mobilier stock had become valuable after the acceptance of the Ames contract and the discovery of the Evans Pass, and McComb claimed by virtue of some arrangement which he had made with Dr. Durant that he was entitled to subscribe at par to some shares which the directors had placed in Ames' hands, and which had been entered on the stock books of the Credit Mobilier in the name of "Oakes Ames, Trustee." Ames held 343 shares "as trustee" apart from the stock which he held in his own name. The correspondence between Ames and McComb had reference to these 343 shares of Credit Mobilier stock.⁵

McComb tried to induce Ames to turn over a portion of this stock to him; but Ames refused to do as McComb wished. In the summer of 1868 McComb brought suit in a Pennsylvania court against the Credit Mobilier, for the recovery of this stock which had been assigned to Ames, and to which McComb claimed that he, not Ames, was entitled to subscribe. In this suit McComb alleged that the shares which he sought to obtain and which stood in the name of Oakes Ames, Trustee,

⁴ "Washburne's move" refers probably to an attempt which Representative Elihu Washburne of Illinois made in 1868 to induce Congress to pass an act lowering rates and fares on the Union Pacific. Washburne had been a member in 1864, and had opposed the passage of the act of 1864.

⁵ Poland Report, pp. 90-94, testimony of John B. Alley; pp. 15-19, testimony of Oakes Ames.

had been distributed by Ames among members of Congress for the purpose of influencing the policy of Congress toward the Union Pacific Railroad. Nothing came of McComb's charges at that time. The suit which he instituted dragged on for some time without result. McComb at length threatened to publish Ames's correspondence. Ames said:

The price of secrecy offered was the compromising with McComb. Though perfectly aware of what I had done and my motives, so confident was I in my innocence of all evil design, that I refused to pay one dollar. . . . He (McComb) referred to these letters and said they were very damaging. I told him to publish them if he chose.⁶

McComb waited for what he thought was a suitable time to carry out his threat, and at length, in the fall of 1872, in the midst of a national political campaign, he published the letters.

Ames had been anxious to interest men of prominence in the Union Pacific Railroad. He had undertaken in the spring of 1867 to place among some of his congressional colleagues the 343 shares of Credit Mobilier stock which stood in his name as trustee. Ames offered small amounts of Credit Mobilier stock at par to a number of members, representing to them that the Credit Mobilier was a construction company which was building the Union Pacific Railroad, and that its stock offered a good opportunity for profitable investment. By offering to guarantee investors against loss and to buy back their stock in case they might wish later to withdraw, Ames interested a number of prominent congressmen in the Credit Mobilier.⁷ Some of the men who invested became frightened later on when they heard of McComb's suit, and availed themselves of Ames's offer to redeem their stock. During the year 1868 the Credit Mobilier paid very large dividends. Between December 12, 1867, and December 29, 1868, \$20,-

⁶ *Ibid.*, p. 22, testimony of Oakes Ames; see also p. 91, testimony of Alley.

⁷ Poland Report, p. 19, testimony of Oakes Ames.

471,668 in securities were distributed as dividends upon a capital stock of \$3,750,000;⁸ and the stock is said to have been worth from 160 to 300 per cent of its par value.⁹

After the *New York Sun* published Ames's correspondence with McComb, the Credit Mobilier became important politically during the national presidential canvass of 1872. The Democrats saw their opportunity and were quick to seize it. If the Republicans had not been in such overwhelming strength, the Credit Mobilier might have influenced the result of the election.¹⁰ Exaggerated charges were made by campaign orators. Democratic papers accused prominent Republican congressmen and senators of having received enormous bribes. Oakes Ames was said to have distributed Credit Mobilier stock without consideration, in order to prevent any possible investigation of that corporation's transactions, and in order to secure congressional favors for the Union Pacific Railroad. Vice-President Colfax, Representative James A. Garfield, Speaker James G. Blaine, and Grant's running mate, Henry Wilson, were among the men who were charged with having corrupt association with the "Pacific Railroad Ring." Speaker Blaine, Vice-President Colfax, and others who were named, publicly denied all connection with the Credit Mobilier. But denials did not satisfy. The Ames letters were constantly alluded to in support of the charges. While the Republican press referred to the charges as "campaign lies," Democratic papers pressed the attack and pointed to this "scandal" as one indication of the need of national reform.

Credit Mobilier Investigation; the Wilson and Poland Reports

The Credit Mobilier had caused a general feeling of uneasiness through the country, and after the election was

⁸ Wilson Report, p. XVI.

⁹ There were very few sales of Credit Mobilier stock. The estimates of witnesses as to the value of Credit Mobilier varied between the figures given.

¹⁰ James Ford Rhodes, *History of the United States*, New York, 1906, Vol. VII, p. 1.

over Congress decided to investigate the whole matter. When the short session of Congress met in December, Speaker Blaine left the chair of the House, to move an investigation of the Credit Mobilier transactions and of the alleged corruption which was said to exist in Congress. The House adopted Blaine's motion. Two investigating committees were appointed. One committee, whose chairman was Representative Jeremiah M. Wilson, of Indiana, was entrusted with the duty of investigating the relations between the Union Pacific Railroad and the Credit Mobilier, which had enabled stockholders in the latter corporation to receive the enormous profits which were made out of the construction. Investigation of the alleged corrupt relations existing between the Credit Mobilier and certain members of Congress was entrusted to a committee, of which Representative Luke P. Poland, of Vermont, was chairman. The committees began their work at once. Hearings were held in December, January, and part of February. Each day the daily papers in a more or less sensational manner reported the proceedings and the facts which the investigations revealed.

Both committees reported in February.¹¹ The Wilson Report set forth in a condensed form the facts in reference to the affairs of the Union Pacific Railroad and its transactions with the Credit Mobilier which have already been related. In the committee's findings the builders were accused of having broken faith with the government and the people. The committee reported that the policy of the directors of the Union Pacific in contracting with themselves had so affected the road's financial condition that ultimate repayment to the government of the enormous subsidy debt was seriously endangered. Attention was called to the fact that as a result of its inflated capitalization the Union Pacific was at that time weak and poor and on the verge of bankruptcy, so that its

¹¹ The Poland Report was printed as House Report No. 77, 42nd Cong., 3rd sess., and the Wilson Report was printed as House Report No. 78, 42nd Cong., 3rd sess. (serial No. 1577).

control by powerful corporations or speculators was rendered easy to secure.¹²

Subsequent events proved the truth of these assertions. The committee erred, however, in singling out this particular construction company as if it were an extraordinary example of a ring organized for a fraudulent purpose. It appeared plainly enough in the evidence that the construction company, whatever might be its evils, had become an established institution. It had happened frequently that bonds of new railroads had been sold with stock bonuses, and in this particular instance the only unusual feature was that a large part of the capital was furnished by the government in the shape of a subsidy loan. Instead of calling attention to the broader features of the railroad problem, and to the fact that the Union Pacific-Credit Mobilier arrangement was merely an example of uncontrolled railroad finance, the Wilson Report makes a personal attack upon a group of men who had followed the usual method of financing a new railroad enterprise. The effect of watered capitalization and of speculative railroad management upon the public is not even alluded to in the Wilson Report.

The testimony which was taken by the Poland Committee touched a different phase of the Credit Mobilier from that covered by the testimony before the Wilson Committee. In the course of the Poland Committee's inquiry into the relations of certain congressmen with the Credit Mobilier, Oakes Ames appeared not unwilling to relate the facts. He told the committee who had invested, who had refused to invest, and what men later withdrew from their investments. He submitted in evidence his famous "memorandum book" in which he had written down notes of his transactions with members of Congress, and what dividend payments he had made to each one.

From the evidence, it appears that Speaker Blaine had

¹² Wilson Report, p. XXI.

been invited to invest in Credit Mobilier stock, but had declined to do so and had never been in any way connected with the Credit Mobilier.¹³

Representative James A. Garfield's later prominence as President of the United States makes his connection with the Credit Mobilier especially interesting. According to Ames, Garfield had taken 10 shares of Credit Mobilier stock, at par, and had received the regular dividends. From Ames's memorandum book it appears that Garfield was debited with \$1,000, the par value of his shares, and that he received two dividends, one in January, the other in June. These two dividends exceeded by \$329 the \$1,000 with which he was debited. He received no other dividends and seems to have withdrawn later. The entry in Ames's memorandum book is as follows:¹⁴

J. A. G.			
1868	Dr.	1868	Cr.
To 10 share stock		By dividend bonds	
Credit Mobilier of A.	\$1,000.00	Union Pacific Rail-	
Interest	47.00	road, \$1,000 at 80 per	
June 19 to cash.....	329.00	cent less 3 per cent..	\$776.00
		June 17 By dividend bonds	
		collected for your	
		account	600.00
	<u>\$1,376.00</u>		<u>\$1,376.00</u>

Garfield, however, insisted that he had withdrawn from the investment without having realized any profit. The additional entry in Ames's memorandum book of \$329, Garfield explained as a loan which Ames had made to him.¹⁵ Ames was not an accurate man by any means, and his testimony throughout shows a certain degree of apparently unintentional confusion. Therefore the conflicting testimony of these

¹³ Poland Report, p. V. See also Blaine's testimony.

¹⁴ *Ibid.*, p. 297, testimony of Oakes Ames.

¹⁵ *Ibid.*, p. 130, testimony of Garfield.

two men may be due to a misunderstanding of some sort, or to some inaccuracy on the part of Ames. However, as the historian, James Ford Rhodes, suggests,¹⁶ the credibility of Garfield's testimony is somewhat affected by the fact that the committee, which had the advantage of hearing the personal testimony of both men, chose to believe Ames, and found that Garfield had received the \$329 as a Credit Mobilier dividend.¹⁷

Whether or not Garfield did as a matter of fact receive this \$329 as a Credit Mobilier dividend is uncertain. He succeeded in vindicating himself entirely before his constituency. His district three times returned him to Congress; he became a national figure in the political world; he was widely known as an advocate of reform; and when he became a candidate for President of the United States, in 1880, he was elected as a reform President.¹⁸

It appears that Vice-President-elect Henry Wilson had made a small investment in Credit Mobilier and had received some dividends, but had subsequently withdrawn.¹⁹ Charges which had been made against the Secretary of the Treasury, Mr. Boutwell, were shown by the testimony to be without foundation.²⁰

The testimony shows clearly that Vice-President Colfax received dividends amounting, in addition to the par value of 20 shares which he had purchased, to \$1,200. During the campaign of 1872, Colfax had denied all connection with the Credit Mobilier. When he was confronted with Ames's memorandum book, he made an ineffectual attempt to explain away the evidence against him; but his testimony is so full of contradictions, inaccuracies, and misstatements of fact that it carries little weight against the evidence of Ames's memoran-

¹⁶ Rhodes, *History of the United States*, Vol. VII, p. 17.

¹⁷ Poland Report, p. VII.

¹⁸ During the campaign of 1880 sidewalks and fences all over the country were painted with the legend "329."

¹⁹ Poland Report, p. 188, testimony of Henry Wilson. It seems Senator Allison of Iowa also received some dividends which he later returned. Poland Report, pp. 304-8, testimony of Allison.

²⁰ Rhodes, *History of the United States*, Vol. VII, p. 13.

dum book. The exposure of Colfax's relations with the Credit Mobilier ended his political career. Instead of doing as some of the others did, frankly stating the facts and seeking vindication in whatever merit there might be in the position that his interest in the Credit Mobilier was only that of an investor who had made a profitable investment, Colfax persisted in denying that he had ever had any connection with the Credit Mobilier. Colfax and those who, like him, attempted to escape the consequences of their transactions by denying facts which the evidence proved, were forced to retire from public life. Their denials were taken as a virtual admission that what they had done would not bear the light of day.²¹

The Poland Committee found Oakes Ames guilty of selling stock of the Credit Mobilier to members of Congress at much less than its true value, for the direct purpose of influencing them. The committee also found that another member of the House of Representatives, James S. Brooks, who had been a government director of the Union Pacific Railroad in 1868, had misused his office in order to secure a share of the Credit Mobilier spoils. Brooks' son-in-law had at one time held 100 shares of Credit Mobilier stock, 200 shares of Union Pacific stock, and \$5,000 in the Union Pacific bonds, which Brooks had bought, paying much less than their actual value. The committee reported that the action of Brooks in acquiring this stock at much less than its real value, and placing it in his son-in-law's name, had the additional impropriety of being a violation of that provision of the chartering acts which forbade government directors from having any pecuniary interest in the Union Pacific.²² The expulsion of both Ames and Brooks was recommended; but the House was content with passing a vote of censure upon them. Neither Ames nor Brooks lived very much longer. Brooks died a few weeks after the com-

²¹ A Senate investigating committee found Senator Patterson of New Hampshire guilty of bribery and perjury in connection with the Credit Mobilier; but as his term expired on March 4, 1873, five days after the committee reported, no action was taken on the committee's recommendation that he be expelled from the Senate. (Sen. Report No. 519, 42nd Cong., 3rd sess., serial No. 1550.)

²² Poland Report, p. XI.

mittee made its report. The death of Oakes Ames occurred in June, 1873.

Political and Moral Aspects of the Credit Mobilier Episode

The Credit Mobilier episode presents two important aspects. One is the reported use of Credit Mobilier stock in order to secure congressional favor for the builders of the Union Pacific Railroad. According to Mr. Ames's own statement, he sold this stock to members of Congress at a price which was very much lower than the stock was worth. He insists, however, that during the winter and spring of 1867 he had made verbal engagements with some of the members to secure for them stock in the Credit Mobilier; but that as Congress adjourned before he could obtain the stock with which to carry out his agreements, he arranged to have the stock when Congress should meet in the fall.²³ In a few instances the evidence bears out this statement. During the quarrel between Ames and Durant, and the trouble on account of his injunctions, in 1866 and the spring of 1867, the stock was not so valuable as it later became. It was not worth more than par in the winter of 1866-1867. Before Congress met in the fall of 1867, the acceptance of the Ames contract and the discovery of the Evans Pass had greatly increased the stock's value. Ames's contention was that after the stock had become valuable, he was in honor bound to fulfil the engagements he had made. Another witness examined by the Poland Committee, Cornelius Bushnell, declared that those who took Credit Mobilier stock in the "dark days" of the spring of 1867 were entitled to it.²⁴ From the evidence, however, it would seem that this was the case only in a very few instances. Both Ames's letters to McComb and the oral testimony show that many shares of stock were not placed until after December, 1867.

Ames also insisted that he could have had no object in

²³ Poland Report, pp. 17, 19, testimony of Oakes Ames.

²⁴ *Ibid.*, p. 180, testimony of Cornelius Bushnell.

bribing congressmen, since the Union Pacific had no more need of congressional favors and desired no more favors of Congress than it had already obtained. He explained that his purpose was to secure general, widespread, favorable interest in the work,²⁵ and declared that he could see no impropriety in his transactions with members of Congress.²⁶ His entire readiness to relate all the facts without any effort at concealment would apparently indicate that he spoke the truth when he said that he failed to see any impropriety in what he had done. Ames declared that it was his purpose to have the members whom he knew become financially interested in the work, and therefore that he was anxious to offer them an interest "on the ground floor." "We wanted capital and influence," Mr. Ames told the Poland Committee. "Influence not on legislation alone, but on credit, good, wide and a general favorable feeling."²⁷

The Union Pacific-Credit Mobilier people had some reason to fear attacks which might be made upon them in Congress. There were members like Washburne of Illinois, who believed that stricter regulations should be imposed on the company. Other members were urging an investigation into the manner in which the builders were making the enormous profits which many openly asserted they were making. "Raids" by speculators for the purpose of depreciating Union Pacific securities, and attacks by men acting in the interest of the rival Central Pacific, were likewise feared. It is probable that Ames wished to stimulate the watchfulness of friendly congressmen by getting them to invest in the Credit Mobilier; for experience, especially congressional experience, had taught him that men are apt to be especially careful in guarding their own property. It is doubtless true that the Union Pacific did not affirmatively seek additional congressional favors; but congressional hostility was something which the company was exceedingly anxious to ward off.

²⁵ *Ibid.*, p. 16, testimony of Oakes Ames.

²⁶ *Ibid.*, p. 46, testimony of Ames.

²⁷ *Ibid.*, p. 16, testimony of Oakes Ames.

It appears to have been this motive which guided Ames's actions. His letters to McComb are the carelessly written letters of a careless man. In them he made use of a number of unguarded expressions. Bribery in its ordinary meaning is hardly the word to characterize Ames's transactions. With curious inconsistency, the Poland Report accused Ames of bribing, while at the same time it exonerated the men who received the Credit Mobilier stock and its accompanying dividends of any improper motive in so doing.

Oakes Ames was apparently a typical product of business conditions and of business ethics of the Reconstruction period. He was no better and no worse than his time. The course which he and his associates in the Union Pacific followed, both in reference to the construction of the road and in reference to members of Congress, was not different from the course followed by other railroad promoters. As one writer points out,²⁸ Ames's transactions came to light at a time of an awakened public conscience. "The parties connected with the Credit Mobilier and the construction of the road are now to be tried by a standard foreign to the time and circumstances under which the work was done," said Oakes Ames in his defense before the House.²⁹ The public, appalled by the recent revelations of the Erie speculators, the Tweed ring, the frauds in the Indian service, and the other scandals of the period, demanded that someone be sacrificed; and Ames became the victim. As a matter of fact, he was probably quite as honest as the Congress which passed judgment on him for bribery. The same Congress, the forty-second, which censured Ames, passed the notorious "Salary Grab" Act, which increased congressional salaries and made the increase retroactive, so as to apply to members of the forty-second Congress.

The other phase of this question—the ownership by congressmen of stock in an enterprise which could be favorably

²⁸ Paxson, *The Last American Frontier*, p. 335.

²⁹ *Cong. Globe*, 42nd Cong., 3rd sess., p. 1725.

or unfavorably affected by their votes—calls for some attention. The Credit Mobilier afforded an excellent concrete illustration of the tendency in the direction of interlocking relations between Congress and great public corporations. The Poland Report suggests the situation in these words:

There is a broader view still which we think ought to be taken. The country is fast becoming filled with gigantic corporations, wielding and controlling immense aggregations of money and thereby commanding great influence and power. It is notorious in many state legislatures that these influences are often controlling so that in effect they become the ruling power of the state. Within a few years Congress has to some extent been brought within similar influences.³⁰

Oakes Ames argued that it was no more improper for a congressman to own Union Pacific or Credit Mobilier stock than to own stock in a national bank, or to be interested in some business which could be affected by the tariff.³¹ While there is some force to this argument, it serves rather to emphasize than to excuse the influences which have often manifested themselves in our government. For a member of Congress to sit in judgment where his personal interests are involved certainly is not likely to further national and public interests where they conflict with his individual private advantage. Considering the temptations which are offered, there has, except during the period of the Civil War and Reconstruction, been relatively little corruption in the national government throughout our entire national history; but this more subtle influence has been frequently exerted to accomplish results which may not be for the best interests of the nation. That so many members of Congress should have been in any way connected with the Credit Mobilier as stockholders would seem to be quite as serious as the circumstance that they received their stock at a price less than its real value.

A distinction should also be made between the ownership

³⁰ Poland Report, p. X.

³¹ *Ibid.*, p. 46, testimony of Oakes Ames.

by a member of Congress of stock in an ordinary going business enterprise, such as a bank or a manufacturing establishment, and an interest in a scheme such as the Credit Mobilier, which was purely speculative. The Union Pacific Railroad had been the recipient of liberal subsidies. It had a peculiarly intimate relation with the federal government. Congress had the power to take such action with reference to the Union Pacific as would directly benefit or injure every man who held a share of Union Pacific or Credit Mobilier stock. Says the Poland Report:

We cannot agree to the doctrine which has been urged before us and elsewhere, that it was perfectly legitimate for members of Congress to invest in a corporation deriving all its rights from and subject at all times to the action of Congress. . . . We do not think any member ought to feel so confident of his own strength as to allow himself to be brought into this temptation. We think Mr. Ames judged shrewdly in saying that a man is much more likely to be watchful of his own interests than those of other people.³²

Attempted Recovery of the Construction Profits

The Credit Mobilier investigations disclosed the business methods of a great national corporation which had been chartered and endowed with liberal grants for the purpose of serving the nation; the disclosures of the Credit Mobilier's relations with members of Congress damaged the reputations of a number of men prominent in the political world; two members of Congress, Oakes Ames and James Brooks, suffered the disgrace of a public vote of censure. These were the net results of the whole inquiry. If any frauds had been committed, as both committees reported, the Credit Mobilier people retained the fruits.

To be sure, Congress, acting upon the report of the Wilson Committee, included the following section in the legislative, executive, and judicial appropriation bill passed in the spring of 1873:

³² Poland Report, p. IX.

SECTION 4. The Attorney-General shall cause a suit in equity to be instituted in the name of the United States against the Union Pacific Railroad Company and against all persons who may, in their own names or through any agents, have subscribed for or received capital stock in said road, which stock has not been paid for in money, or who may have received as dividends or otherwise, portions of the capital stock of said road, or the proceeds or avails thereof, or other property of said road, unlawfully and contrary to equity, or who may have received as profits or proceeds of contracts for construction or equipment of said road, or other contracts therewith, moneys or other property, which ought, in equity, to belong to said corporation, or who may, under pretence of having complied with the acts of which this is an addition, have wrongfully or unlawfully received from the United States bonds, moneys, or lands which ought in equity to be accounted for and paid to said railroad company or to the United States, and to compel payment for said stock, and the collection and payment of such moneys, and the restoration of such property, or its value, either to the railroad corporation or to the United States, whichever shall in equity be entitled thereto.³³

In pursuance of this act, the Attorney-General, in the name of the United States, commenced an action in equity in the United States Circuit Court for the District of Connecticut, against the Union Pacific Railroad Company and others, for the recovery of the alleged fraudulent profits which the Credit Mobilier people made out of the construction contracts. The bill passed by Congress had directed that a suit be brought against the Union Pacific Railroad to recover property which in equity belonged to the Union Pacific Railroad. Suit was brought by the United States against the Union Pacific to recover the moneys and profits which, it was alleged, had been wrongfully paid as dividends to the Credit Mobilier stockholders.

The railroad company demurred to the complaint on the ground that it was made both a plaintiff and a codefendant in

³³ 17 Stat. L. 509.

this action, and on appeal to the Supreme Court of the United States the demurrer was sustained. A lengthy opinion written by Mr. Justice Miller and delivered on January 6, 1879, may be thus summarized: Under the complaint the railroad company was made both plaintiff and defendant in the same action. If there were any recovery, in whose favor should judgment be rendered? The railroad company refused to prosecute any suit against the Credit Mobilier, or against the Credit Mobilier stockholders. No recovery could lie in favor of the United States, for the government was merely a creditor of the railroad company and had only a creditor's interest. Therefore, until the subsidy bonds matured the government had no right of action. Recovery could lie only upon the complaint of an injured stockholder.³⁴ This suit therefore had no result except to render the Credit Mobilier people more secure in their possession of the profits which they had made during the road's construction.

The shadow of the Credit Mobilier followed the Union Pacific for many years. The achievement of building the first transcontinental railroad can never be dissociated from the two investigations which followed its completion. The distrust of the company which developed as a consequence of the Poland and Wilson disclosures was one element which brought about a long period of strained relations between the government and the Union Pacific Railroad; and the effect of these disclosures on the popular mind was undoubtedly one of the influences which have created a widespread popular distrust of and dissatisfaction with railroad corporations in general. We are accustomed in the United States to charges that the railroads and railroad lobbies have exercised in the state and national governments an undue and often improper influence upon legislation. It is, however, usually extremely difficult to get the exact facts concerning this phase of railroad history;

³⁴ *United States v. Union Pacific Railroad Company et al.*, 98 U. S. 569; 25 L. Ed. 143.

but the facts in the Credit Mobilier episode are for the most part not disputed. Whatever difference of opinion there may be in reference to the Credit Mobilier is confined to the way in which these facts should be interpreted.

James G. Blaine's Alleged Relations with the Union Pacific

Three years after the Credit Mobilier investigations another legislative "scandal," or what many have believed to be a scandal, was unearthed, concerning certain alleged improper relations between the Union Pacific Railroad and the great Republican leader, James G. Blaine. Mr. Blaine was of such national prominence, and his position as Speaker of the House of Representatives was such a powerful one, that the circumstances of this incident received wide publicity and had far-reaching consequences in shaping the political history of the United States. It will be remembered that during the campaign of 1872, Mr. Blaine had been charged with being improperly involved in the Credit Mobilier. From the testimony taken by the Poland Committee it appeared that while Blaine had at one time been invited to take some stock in the Credit Mobilier, he had declined to do so and had never had any connection whatever with that corporation. Although this charge was found to be groundless, rumors that Blaine had been involved in some improper transactions with the Union Pacific persisted. These rumors took definite shape in a charge which was made in the spring of 1876 in regard to some transactions in which Blaine was said to have been involved four years before, namely, in 1872.

In the *Cincinnati Gazette* of April 27, 1876, a John G. Harrison, who had been a government director of the Union Pacific Railroad in 1872, gave out an interview in which he asserted that he had, at a board meeting on September 11, 1872, moved that an inquiry be made by the directors into the purchase of some bonds of the Little Rock and Fort Smith Railroad Company, of which the Union Pacific had in some way

obtained possession. The face value of these bonds was \$75,000, and for them, according to the books of the Union Pacific, that company had paid \$64,000. They had a very uncertain market value and could not have sold for anything like \$64,000 in the open market. Harrison related that he had no sooner moved this investigation than E. H. Rollins, the treasurer of the company, called him aside and told him to withdraw the motion. The reason Rollins gave for this request was that an investigation into the history of these Little Rock bonds would involve Mr. Blaine, the Speaker of the House, and greatly endanger his chances of re-election to Congress. Harrison, deeming it unwise to press the issue at that time, withdrew his motion. However, during the following winter, when the Wilson Committee was investigating the affairs of the Union Pacific Railroad, Harrison, according to this interview, telegraphed to the committee to investigate the purchase of these Little Rock bonds. If Harrison's account is true, the committee paid no attention to the suggestion. No action in regard to the matter was then taken and Mr. Harrison allowed it to drop for the time being.³⁵

The interview reported in the *Cincinnati Gazette* attracted particular attention on account of the fact that the year 1876 was a presidential year. The national nominating conventions would meet in the early summer, and Mr. Blaine, on account of his great national prominence, was the leading candidate for the Republican nomination. The House, which was at that time Democratic, passed, on May 2, 1876, less than one week after the publication of this interview, a resolution ordering an inquiry.³⁶

The investigation was conducted by a subcommittee of the Judiciary Committee, consisting of two southern Democrats,

³⁵ For Harrison's story see House Misc. Docs. No. 176, 44th Cong., 1st sess. (serial No. 1706), p. 18. This document is entitled "The Disposal of Subsidies Granted to Certain Railroad Companies," and will hereafter be referred to as "Certain R. R. Cos."

³⁶ Cong. Record, 44th Cong., 1st sess., p. 2884.

Representatives Hunton and Ashe, and one northern Republican, Representative Lawrence.

Blaine, it seems, had in 1869 been interested in this Little Rock and Fort Smith Company. On the strength of his recommendation, certain of Blaine's Maine friends had invested in this road's bonds. When the project later met with difficulties which compelled its temporary abandonment, Mr. Blaine, according to his own subsequent explanations, felt in honor bound to redeem the bonds purchased by his Maine friends, and so make good their losses. In 1872, as a result of his interest in this Little Rock road, Blaine became financially embarrassed and it was with great difficulty, borrowing money at rates as high as 8 per cent in some cases, that Blaine repurchased these Little Rock bonds.³⁷ It happened that about the same time three other railroad companies, the Union Pacific, the Missouri, Kansas and Texas, and the Atlantic and Pacific, acquired some Little Rock bonds; 75 of these bonds, the face value of each being \$1,000, were purchased from someone by the Union Pacific.

So far the evidence is clear; but from this point conflicting testimony makes it impossible to settle the question as to whether or not the Union Pacific and these two other companies relieved Blaine of his financial burden by purchasing of him these Little Rock bonds, with a view to influencing his conduct as Speaker of the House, or whether the company had obtained these bonds elsewhere. The investigation ordered by the resolution referred to was begun; and during the course of this investigation, Harrison repeated under oath the statements he had made in the *Cincinnati Gazette*.³⁸ However, his testimony was unsupported. Mr. Rollins, the treasurer of the Union Pacific, reminded the investigators that on the date when Harrison reported their conversation about Mr. Blaine as having taken place, the Maine election had already been held

³⁷ Rhodes, *History of the United States*, Vol. VII, pp. 196, 197.

³⁸ Certain R. R. Cos., p. 18 ff., testimony of Harrison.

two days before.³⁹ Rollins declared that Blaine had never had any transaction of any sort with the Union Pacific. These Little Rock bonds, according to Rollins' testimony, had been purchased, not from Blaine, but from Thomas A. Scott, who at that time (1871-1872) was president of the Union Pacific.

Mulligan's Charges; the "Mulligan Letters"

Scott was also prominently connected with the Pennsylvania road, and in the spring of 1871 he became president of the Union Pacific. At this time the Union Pacific was financially distressed, and it seems that no agreement was made regarding the amount of salary Scott was to receive for his services as president. His administration lasted one year. During that time it happened that the company's financial condition improved and its securities rose greatly in value. This result Scott attributed, whether rightly or not, to his own labors, and to the credit which he and his associates in the Pennsylvania were able to bring to the Union Pacific.⁴⁰ The Union Pacific directors apparently were of the opinion that Scott's estimate of the value of his own services to the company was correct. It was mutually agreed that he was entitled to compensation.⁴¹ Scott held 75 land grant bonds of the Little Rock and Fort Smith Railroad, which he says he had purchased from one Josiah Caldwell, the promoter of the Little Rock road, at 80 cents on the dollar. These securities had greatly depreciated in 1871, in consequence of the road's temporary failure. As they were not listed on the stock exchange, their market value cannot be fixed with any certainty. Scott fixed their value between 50 and 60 per cent of their face; while other witnesses swore they were not worth more than from 10 to 25, or at most, 40 per cent.⁴² Ostensibly for the purpose of making an equitable settlement with Scott in recog-

³⁹ Certain R. R. Cos., p. 27, testimony of E. H. Rollins.

⁴⁰ *Ibid.*, pp. 47 ff., testimony of Scott.

⁴¹ *Ibid.*, p. 67, testimony of Sidney Dillon.

⁴² *Ibid.*, p. 49, testimony of Scott; p. 78, testimony of David B. Sickles; p. 86, testimony of William P. Denckla; p. 88, testimony of Warren Fisher.

nition of his services, the executive committee of the Union Pacific agreed to purchase these bonds from him and to pay him \$64,000 for them.

The truth of the above account of the history of the purchase of the Little Rock bonds was sworn to not alone by Scott, but by E. H. Rollins, Andrew Carnegie, Levi P. Morton, Sidney Dillon, and other men who apparently were in a position to know the details of the transaction. At first there was no evidence to the contrary, except Harrison's contradicted testimony, although there was the coincidence that the Union Pacific had come into possession of these bonds about the same time that Blaine had made good the losses of his Maine friends.

A new witness, James Mulligan, suddenly appeared before the committee and testified that Elisha Atkins, one of the directors of the Union Pacific, had told him that Scott bought these bonds of Blaine and paid him \$64,000 for them.⁴³ Mulligan, it seems, had been some sort of confidential clerk to a man named Warren Fisher, with whom Blaine had had private business dealings. Mulligan's charge was based on hearsay, and would not be admissible as evidence in any court; but in the course of his testimony he referred to certain letters which Blaine had written to Fisher in regard to some private business transactions, which letters Mulligan had in some way obtained. Mulligan testified that in one of these letters Blaine had admitted receiving money from the Union Pacific; the letters also, according to Mulligan, contained references to certain other improper transactions which Blaine had had with other railroad companies.⁴⁴

Mulligan's statement in regard to Atkins' admission that Scott gave Blaine \$64,000 for 75 Little Rock bonds is not borne out affirmatively either by Mr. Atkins or by any other witness. Atkins' testimony is, however, somewhat uncertain and somewhat contradictory, and his statements cannot be con-

⁴³ Certain R. R. Cos., p. 95, testimony of Mulligan.

⁴⁴ *Ibid.*, pp. 96, 101, testimony of Mulligan.

sidered as absolutely disproving Mulligan's story. While the weight of verbal evidence is against Mulligan, there is enough uncertainty to make it impossible to determine just what were the facts. Mulligan's testimony is direct and his statements are consistent, but they lack corroboration.

The question of who received the \$64,000 was, therefore, one of veracity. The curiosity of the committee was aroused by Mulligan's reference to Blaine's correspondence, and the members were about to pursue their investigation in this direction as well, when Blaine objected to the exposure of his private business transactions with Fisher; these letters, Blaine maintained, had no bearing upon the matter under investigation, but related to other matters not connected with the Union Pacific. Before the committee decided whether or not to continue its inquiry in this direction, an adjournment was taken.

The following day, June 1, 1876, Mulligan informed the committee that Mr. Blaine had managed to get hold of these letters the previous evening and that he refused to return them. The story Mulligan told became widely known on account of its sensational and extraordinary details. He testified that Blaine had come to him and had begged and entreated him to give up the letters; that Mulligan refused to do this; that Blaine then requested permission to look at the letters, and promised to return them; and that Mulligan allowed Blaine to look at them, but that Blaine, contrary to his promise, had refused to give them back.⁴⁵

Blaine denied a great part of Mulligan's testimony. He admitted having gone to Mulligan on the previous evening, but he denied having begged Mulligan to give the letters to him. Blaine said that he merely asked to look at the letters and that he had made no promise to return them to Mulligan. His reason for refusing to return the letters, he told the committee,

⁴⁵ In this account of the episode of the Mulligan letters, certain details which do not bear on the history of the Union Pacific have been omitted. Mulligan declared that Blaine had on his knees besought him with tears in his eyes not to give the letters in evidence, as their publication would bring disgrace and political ruin upon him. Mulligan's story is on page 98, Certain R. R. Cos.

was because he did not propose to subject his private letters to the scrutiny of the world.⁴⁶

Blaine's Defense

The committee asked Blaine to produce these letters. Blaine refused, asserting that he had been advised by counsel that the correspondence bore no direct relation to the subject under inquiry. Mulligan himself admitted that the Union Pacific matter was referred to in only one letter.⁴⁷ The two southern Democratic members of the subcommittee, Representatives Hunton and Ashe, seized the opportunity to make capital out of Blaine's refusal, and pursued the investigation along a line which had no reference to the original Union Pacific matter.

Blaine could not fail to see that his refusal to submit the letters in evidence was seriously affecting his political strength. Finally, on June 5, 1876, Blaine in a dramatic address in the House of Representatives, flatly denied that he had ever had any connection with the Union Pacific. He declared in this address that he would, in order to remove all suspicion, disclose the contents of these letters which were said to be incriminating. He then read the letters, and in not one as he read them, was there anything to prove that he had been involved in any questionable transaction. The nearest reference in any of the letters to the Union Pacific matter was the following sentence, which Mulligan had construed as an admission by Blaine that he had received the \$64,000:

The sales of bonds which you spoke of my making, and which you seemed to have thought were for my own benefit, were entirely otherwise. I did not have the money in my possession forty-eight hours but paid it over directly to the parties whom I tried by every means in my power to protect from loss.⁴⁸

⁴⁶ Certain R. R. Cos., p. 105, testimony of Blaine.

⁴⁷ *Ibid.*, p. 123, testimony of Mulligan.

⁴⁸ Cong. Record, 44th Cong., 1st sess., p. 3605.

Blaine did not comment on this sentence, although he carefully explained other portions of the correspondence. Whether this sentence referred to the Union Pacific, as Mulligan assumed, is uncertain.

Blaine concluded a very dramatic defense by declaring that Representative Knott of Kentucky, the chairman of the Judiciary Committee, had received a cablegram from Josiah Caldwell, who was then in London, which completely exonerated Blaine from all connection with the \$64,000 transaction, and corroborated President Scott's testimony in every detail. Knott was forced to admit that he had received such a telegram and that he had suppressed it.

Although Blaine read what he said were the contents of these letters, he did not, however, permit anyone to examine them. Many of his opponents suspected that he might not have read all of their contents. Five days after his speech in the House, Blaine informed the committee that he was willing to produce and submit in evidence the one letter which was said to bear upon the matter under inquiry, provided the committee would recognize his right to withhold the others.⁴⁹ The committee refused to agree to this proposition, and Blaine therefore refused to produce any of the letters.

Immediately after Blaine's last refusal, the committee adjourned. Before it could meet again, Blaine was taken suddenly ill from the effects of a sunstroke. During his illness the Governor of Maine appointed him to fill a vacancy in the United States Senate. As Blaine was no longer within the jurisdiction of the House the committee did not pursue its investigation further and never made a report of its findings.

So far as the question of Blaine's connection with the \$64,000 transaction is concerned, the evidence seems to be contained in the verbal testimony before the committee. Even if Blaine had submitted the letters in evidence, they probably would not have shed any additional light on this matter; for

⁴⁹ Certain R. R. Cos., p. 174, testimony of Blaine.

Mulligan admitted that except for the one sentence which was quoted above, the letters did not have any direct bearing upon the specific subject under inquiry, namely, Blaine's alleged improper relations with the Union Pacific Railroad. Whether Scott obtained the bonds which cost the Union Pacific \$64,000, from Caldwell or Blaine, must remain a question of veracity between Mulligan and Harrison on one side, and Blaine and the company's officers on the other.

Blaine's refusal to permit an examination of these letters, and his failure to make a complete explanation of every suspicious circumstance connected with the incident, has led many people to suspect that he did not read all that was in the letters, and that if their contents were disclosed fully they would show that Blaine had been involved in some transactions with railroad companies which would not bear exposure.⁵⁰ Blaine never succeeded in clearing himself completely. The incident of the Mulligan letters caused Blaine's failure to secure the Republican presidential nomination in 1876, and it was probably an important factor in contributing to his defeat in 1884.

Exposures of corruption in the national government, as well as in local governments, were not uncommon during the Reconstruction period. The Credit Mobilier and the charges against Speaker Blaine, both of which involved the Union Pacific directly, stand out as conspicuous examples. While the Credit Mobilier has not wanted apologists, and while Blaine's complicity with the Union Pacific—Little Rock and Fort Smith affair has never been proved, these two incidents could necessarily create a general feeling of distrust and suspicion of the honesty of the methods of this great subsidized national railroad company. That national figures like Blaine, Ames, and Colfax should be prominently mentioned as objects of suspicion in connection with questionable transactions with the men who were the managers of a great national highway of

⁵⁰ Rhodes is of the opinion that there is little doubt as to Blaine's guilt so far, at least, as the Union Pacific was concerned. (History of the United States, Vol. VII, p. 204.)

commerce, was sufficiently serious. Whether or not the men connected with the Credit Mobilier "scandal" were justified in what they did, and whether Blaine was rightly or wrongly accused of having used his high office of Speaker of the House of Representatives to obtain favors for a nationally incorporated and government-aided railroad, these two incidents in the congressional history of the Union Pacific have been, as has already been suggested, contributing elements in bringing about the unfriendly attitude of the public toward great railroad companies.

CHAPTER V

THE DECADE FROM 1870 TO 1880

Acquisition by Jay Gould of Control of Union Pacific

An excellent illustration of the effect of overcapitalization upon a railroad company is afforded by the history of the Union Pacific from the time of its construction down to the closing years of the last decade of the nineteenth century. The extravagant manner in which the Union Pacific was built left its stamp upon the finished road. For a number of years after 1869 the company found difficulty in meeting its heavy interest obligations. In January, 1873, its president testified that only the personal credit and financial assistance of the directors and leading stockholders kept the road out of a receivership, and that if this aid were withdrawn the road must surely be bankrupted.¹ Its bonds did not command high prices; its capital stock had only a speculative value; and, as the report of the Wilson Committee had pointed out, it was easy for powerful corporations or speculators to secure control of it. As a matter of fact this is what did actually happen.

The volume of traffic which passed over the Union Pacific even as early as 1870 greatly exceeded all previous expectation. The road's completion made possible the immediate development of the great resources of the west. For example, formerly only high-grade ores could pay a profit over transportation charges, while now mining products of an inferior grade were able to find an outlet. In 1873, there were within 12 miles of Salt Lake City 11 furnaces for the reduction of ores, and in the state of Utah there were over 30 such furnaces, all of which had developed since the road's comple-

¹ Wilson Report, p. 396, testimony of H. A. Clark.

tion.² This was only one industry which developed in the west by reason of the completion of this road. The road did a heavy transcontinental and tourist business, which high tariff rates made very remunerative. So surprisingly large was the road's business at this time that if the Union Pacific had been capitalized at a moderate figure the question of its solvency would not have arisen.

Control of all this traffic after it came east of the eastern terminus of the Union Pacific was sought after by eastern roads. Between 1870 and 1873 the Pennsylvania and the Lake Shore and Michigan Southern interests each in turn controlled the Union Pacific. Early in 1871 the road came into the control of men prominent in the management of the Pennsylvania Railroad, and Thomas A. Scott of the Pennsylvania Company became president of the Union Pacific. The Pennsylvania people remained in control for one year. In 1872, Commodore Vanderbilt's son-in-law, Horace A. Clark, of the Lake Shore and Michigan Southern road, bought a dominating interest in the Union Pacific in order to divert its traffic to the Lake Shore and Michigan Southern.³ Mr. Clark was elected president of the Union Pacific in March, 1872, and remained in that position until his death in the late spring of 1873, sometime after the Credit Mobilier investigations.

After Clark's death, Sidney Dillon was elected president. Clark's stock, which was for some reason thrown upon the market, fell into the hands of Jay Gould. During the year 1873 Gould made large additional purchases of Union Pacific stock, which at that time had a market value of from 25 to 30. Gould seems to have acquired about 100,000 shares, or nearly one-third of the entire outstanding capital stock.⁴ After 1873 he continued to increase his holdings, until by 1878 he had acquired about 200,000 shares.⁵

² Report of two of the Government Directors of the Union Pacific Railroad, dated Dec. 1872, House Exec. Docs. No. 95, 43rd Cong., 1st sess. (serial No. 1607), p. 8, at p. 13.

³ Wilson Report, p. 666, testimony of Clark.

⁴ Pac. Ry. Com., Test. p. 446, testimony of Jay Gould.

⁵ *Ibid.*, p. 451, testimony of Gould.

Gould's purpose, as his subsequent actions indicated, was to place the road, for a time at least, upon a dividend-paying basis. First of all he brought about a partial reorganization of the road's finances. The company had been struggling under a heavy floating debt on which it was paying high interest rates.⁶ Interest charges amounting to 10 per cent per annum were likewise paid upon 10,000,000 income bonds, which income bonds fell due soon after Gould came into the management. A new series of 8 per cent "sinking fund bonds" was floated under Gould's direction. These bonds provided for the redemption of the income bonds as fast as they matured, and for funding the floating debt;⁷ \$14,500,000 of these sinking fund bonds were issued. They were a second mortgage on the land grant and a third mortgage on the road. While there was little change in the principal of the company's floating and funded debt, this arrangement saved many thousands of dollars of interest charges annually.

Relatively Large Earnings of Union Pacific

The tremendous increase in traffic which accompanied the rapid filling up of the west aided Gould in his purpose to place the company on a dividend-paying basis. The Union Pacific taught our people that the stories of the "American Desert" were greatly exaggerated. The railroad solved the problem of Indian outbreaks and made possible the settlement of the far west. The trans-Missouri region was now open. Population began rapidly pouring into Colorado, Montana, Utah, and other western localities. A comparison of the population of certain selected towns and cities for the years 1860, 1870, and 1880 shows a general increase, not alone in mining centers, but all along the line:⁸

⁶ *Ibid.*, p. 447, testimony of Gould.

⁷ *Ibid.*

⁸ The figures in this and the following table have been compiled from the United States Census for 1860, 1870, and 1880.

	1860	1870	1880
Omaha, Neb.....	1,883	16,083	30,518
Fremont, Neb.....	....	1,195	3,013
Denver, Colo.....	4,749	4,759	35,629
Cheyenne, Wyo.....	....	1,450	3,456
Laramie, Wyo.....	....	828	3,696
Ogden, Utah.....	1,476	3,127	6,069
Salt Lake City, Utah.....	8,236	12,854	20,768

The four states and territories through which the Union Pacific ran increased rapidly in population, as the following table shows:

	1860	1870	1880
Nebraska	28,841	122,993	452,402
Colorado	34,277	39,864	194,327
Wyoming .....	.....	86,786	143,966
Utah	9,118	20,789	40,273

Western development during the eight years following the construction of this railroad was so marked that the government directors wrote in their official report for 1878, "The 'perfect waste' . . . teems with farms and villages, and herds of cattle and flocks of sheep, and embraces mineral wealth, developed and undeveloped, beyond comprehension and almost too great for human belief."⁹ The same report contains a few statistics illustrative of this development. For example, in 1876, during June, July, August, and September, 20,260 head of cattle were shipped east over the Union Pacific from North Platte and stations west of North Platte. During the same season the railroad company mined 227,644 tons of coal at its various mines along its line. The increase in mineral output is indicated by the shipments of western ore which were received from the west by one large Omaha smelting concern:

YEAR	LEAD (LBS.)	GOLD AND SILVER (DOLLARS)	SHIPPED FROM
1873	8,482,386	\$1,020,639.54	Utah
1874	13,586,909	1,184,611.34	Utah and Nevada
1875	22,524,000	2,252,925.11	Utah, Nevada, and Montana

⁹ Report of the Government Directors, 1878, in House Exec. Docs. No. 69, 49th Cong., 1st sess., (serial No. 233, pp. 109 ff., at p. 111). (This document is a compilation of reports from 1864 to 1885.)

The same report of the government directors called attention to the increase in the amount of Oriental commerce which passed over the company's lines. Thus, for the year ending June 30, 1875, 9,754,774 pounds of tea, and 181,638 pounds of silk were carried by the Union Pacific; while for the twelve months ending June 30, 1876, the figures were increased to 23,214,504 pounds of tea, and 1,252,953 pounds of silk.

Doubtless there may be some errors in these estimates, but nevertheless, making all due allowance for inaccuracies, it is apparent from these figures that a tremendous increase in industrial development occurred in the west during the seventies. The best index of the situation is the increase in the company's annual income. Its net earnings (gross earnings minus the expenses of operation) from 1868 to 1875 were:¹⁰

1868.....\$ 893,921.99	1872.....\$4,092,032.05
1869.....2,031,170.09	1873.....5,222,891.30
1870.....2,776,771.88	1874.....5,424,997.13
1871.....3,921,115.30	1875.....6,451,552.74

In the seventies the traffic of Nebraska, Wyoming, Utah, Montana, Idaho, Nevada, California, Oregon, and Washington, and to some extent Colorado, was entirely dependent upon the Union Pacific. The only competition the road met with was that of steamships plying between the east and California. With an entire monopoly of the western carrying trade, except for a portion of the California business, and with no rate laws in force, the Union Pacific was in a position to fix rates as high as it saw fit. The problem of railroad rates and their proper relation to a road's physical valuation and earning capacity has been thoroughly discussed by economists and students of railroad questions. This problem therefore does

¹⁰ These are the figures reported by the Pac. Ry. Com. (Test. p. 4802. Reports of accountants.) The figures given above are those taken from the Omaha books. The Boston books give different figures for 1868, 1869, and 1870. The railroad company's published reports also give somewhat different figures. The gross earnings from 1868 to 1875, inclusive, are as follows (Pac. Ry. Com. Test., p. 5266):

1868.....\$ 5,062,671.81	1872.....\$ 8,892,605.53
1869.....8,192,304.05	1873.....10,266,103.66
1870.....7,566,940.65	1874.....10,559,880.12
1871.....7,521,682.16	1875.....11,993,832.09

not properly come within the scope of this work. Nevertheless, some mention must be made of the rate situation as it was on the Union Pacific at this period. In 1878 the government directors reported that the company's policy in respect to rates was neither far sighted nor liberal, and that rates were fixed as high as the officers believed the traffic would bear.¹¹ A number of specific instances are mentioned of high rates and of what the government directors believed were unfair long and short haul discriminations.

It would not be easy at this distance to determine whether or not these government directors were entirely correct in their criticism of the company's rate policy. Many things must be considered in attempting to pass judgment as to whether or not a given schedule of freight and passenger tariffs is reasonable. The average freight rate per ton per mile on the Union Pacific for certain years selected for comparison was:¹²

	CENTS
1871.....	2.41
1876.....	2.04
1909.....	1.02

Passenger rates are less complex than freight rates and afford a more easily understood basis of comparison. On portions of the mountain divisions local fares were during this period as high as 9 and 10 cents a mile in some cases; but there was very little travel to be affected by these high rates. In 1878 the average local fare was 3.5 cents a mile; the average through fare was 3.13 cents a mile; and the average through and local passenger fare, including emigrant

¹¹ Report of the Government Directors, 1878 (printed in House Exec. Docs. No. 1, 45th Cong., 3rd sess., Pt. 5, serial No. 1850, pp. 1006 ff., at p. 1012).

¹² The figures for 1871 and 1876 are taken from a compilation submitted by the traffic manager of the Union Pacific to the Cullom Investigating Committee on Interstate Commerce, in 1887. (See Sen. Rep. No. 46, Pt. 2, 49th Cong., 1st sess. [serial No. 2357], p. 1231.) The figures for 1909 are taken from the record in the case of *United States v. Union Pacific Railroad Company, et al.*, docket No. 993, Circuit Court of the United States for the district of Utah, Evidence and Proceedings before the Special Examiner, p. 4096, defendant's exhibit No. 68.

rates, was 3.33 cents a mile.¹³ The average rate on the Union Pacific in 1909 was 2.16 cents a mile.¹⁴

Compared with tariffs in force on eastern roads, the rates charged by the Union Pacific at this time were probably not excessive, in view of the physical conditions under which the Union Pacific was constructed and operated, and in view of the still sparsely settled region through which it ran. But it is not too much to say that if a given rate will yield a fair margin of profit upon a road's actual cost—whatever a "fair margin of profit" may be—a higher tariff is an unfair tax levied upon the community, not a fair charge for services rendered. A rate which is profitable upon a fair valuation may be and frequently is insufficient to enable a road to meet the interest on a watered bond issue; and a schedule of rates which permits the payments, in addition to inflated interest charges, of a dividend upon stock that represents only the energy of its promoters must usually be classed as excessive. The question of risk is one which must be taken fully into consideration, and may justify a large return upon the capital invested. But it must not be forgotten that although the Union Pacific was expensive to construct and operate, although its traffic was relatively light as compared with eastern roads, and although its construction involved great risks, the company was heavily subsidized by the government, and capitalized at a figure nearly double the road's physical valuation.

A region which was rapidly increasing in population furnished an annually increasing tonnage to the Union Pacific Railroad, and this tonnage was carried at high rates. The result was a steadily increasing annual revenue to the company. By 1874 the net earnings exceeded the interest on the bonded debt by a considerable margin. The first dividend was declared in the spring of 1875.¹⁵ A quarterly dividend of 1½ per cent, or 6 per cent per annum, upon the capital stock

¹³ Report of the Government Directors, 1878 (serial No. 1850, at p. 1012).

¹⁴ Evidence and Proceedings before the Spec. Ex., p. 4096.

¹⁵ Annual Report of the Union Pacific for 1874.

was paid on July 1 of that year. Three months later the quarterly dividend was increased to 2 per cent, at which rate it remained for a time.

Gould's Dividend Policy

When Gould made his first purchase of Union Pacific stock, in 1873, its market value fluctuated in the neighborhood of 30. The manner in which the stock was originally issued has already been related. After the road's completion shares had occasionally been quoted on the stock exchange as high as 40, while they had sometimes sold as low as 11 or 12.¹⁶ If we estimate the average cost of each share as approximately \$30, a 6 per cent dividend on the par value of the road's capital stock was in fact about 20 per cent on the actual investment; while an 8 per cent dividend on the par value of the stock amounted to over 25 per cent of what had been the average market value up to this time. This very large margin of profit was left to the stockholders after interest on the inflated bond issue had been paid.

There are three reasons why Gould's dividend policy is open to adverse criticism:

1. The amount of the annual dividend was out of all proportion to the investment. The bonded debt was considerably in excess of the road's cost, it bore high interest rates, and the company had received very much less than their par when the bonds were first issued. The stock originally represented no money investment whatever. To be sure, this condition was to some extent a consequence of the risk involved in building the road, and of the difficulty of finding a market for its securities. It is nevertheless true that the builders of the road had already realized a very large profit out of the construction. There was no longer the same element of risk that there had been. It required high tariff rates to enable

¹⁶ Files of the Commercial and Financial Chronicle.

the company to meet its fixed charges and to pay in addition a dividend of 6 or 8 per cent annually upon stock which was originally issued as a gratuity.

2. Yet even if it were to be conceded that this high rate of dividend was not in excess of a fair margin of profit, the dividends were so large as to be financially unsound. A very high percentage of the surplus earnings was divided, so that only a small margin of safety remained after the payment of dividends.

3. No provision was made for the payment of either principal or interest of the United States subsidy bonds. In 1875 the Supreme Court of the United States decided that the government could not require the company to repay the semiannual interest on these bonds until their maturity, thirty years after their issue. The United States was therefore only entitled to collect one-half of the sum due the railroad company on account of government transportation, and, in addition, 5 per cent of the company's net earnings. The sum of these two payments was only enough to meet about one-fourth of the annual interest on the subsidy bonds; but under the Supreme Court's decision none of the balance was due the United States until late in the nineties. That the company would be unable to meet this debt when it matured was admitted in 1874 by Sidney Dillon, the president of the Union Pacific.¹⁷ Nevertheless, between 1875 and 1884, \$28,650,770.13 were paid in dividends,¹⁸ while the unpaid interest obligations owing from the Union Pacific Railroad to the United States amounted to \$15,768,837.98 in 1884.¹⁹

Whether these dividends were made possible at the expense of the physical upkeep of the road is somewhat doubtful. Reports both of different boards of government directors and

¹⁷ Letter of Dillon to the Secretary of the Treasury, printed in the Annual Report of the Company for 1874.

¹⁸ Pac. Ry. Com. Test., p. 4810, reports of accountants.

¹⁹ Annual Report of the Commissioner of Railroads for 1884, p. 12. This figure does not include the overdue interest owing to the government from the Kansas Pacific Railway Company, which was consolidated with the Union Pacific in 1880.

of the railroad company itself contain frequent references to physical betterment and improvements. In 1878, however, the government directors made some criticisms of the physical appearance of the road as not being entirely satisfactory, and reported that the policy of the company in this regard was sufficiently safe but by no means liberal.²⁰ The ratio of operating expenses to gross earnings during these years seems very low, as it averaged only about 40 per cent.²¹ Doubtless the road was fairly well kept up for a western road at that period; but the management did not enter upon any works of improvement except such as were immediately necessary.

In 1875 the company's net earnings amounted to \$6,451,552.74. The following year they increased to \$7,477,408.79. From this time to the close of the decade, net earnings did not vary greatly from this figure. Between July 1, 1875, and January 1, 1880, inclusive, dividends amounting to \$11,942,125 were paid by the company.²²

The stock market at once began to register the effect of Gould's dividend policy. In January, 1876, the lowest quotation of Union Pacific stock was 67½, and the highest was 74½.²³ The market price remained in the neighborhood of 70, and after 1878 Gould took advantage of the increased value of Union Pacific stock to dispose of a large amount of his shares. Gould reduced his holdings from about 200,000 shares to about 27,000 shares.²⁴

The Omaha Bridge

Three other matters belonging to this decade should be mentioned, as they were probably not without influence upon local western sentiment regarding railroads in general and the Union Pacific in particular: (1) the policy of the company

²⁰ The report made by the government directors in 1878 is unusually full in its discussion of the affairs of the Union Pacific. One of the signers of this report was Charles Francis Adams.

²¹ Annual Reports of the company.

²² Pac. Ry. Com. Test., pp. 4802, 4810, reports of accountants.

²³ Chron., 22:136 (1876).

²⁴ Pac. Ry. Com. Test., p. 474, testimony of Jay Gould.

with respect to the Omaha bridge; (2) the policy of the company with respect to its coal department; and (3) the company's attitude toward state taxation.

For some time it was doubtful whether Council Bluffs or Omaha was the eastern terminus of the Union Pacific. The act of 1862 required the Pacific railroad companies to operate their respective roads as one continuous line. The act likewise provided that the "Iowa branch" of the Union Pacific was to commence at "a point on the western boundary of the State of Iowa, to be fixed by the President of the United States." In accordance with the provisions of this act, President Lincoln, on March 7, 1864, had fixed this point so as to be on the western boundary of Iowa, "within the limits of the township in Iowa opposite the Town of Omaha, in Nebraska."²⁵ In 1871 the Union Pacific finished the construction of a bridge over the Missouri River at Omaha. The company, taking the position that the western boundary of Iowa was on the west bank of the river, did not operate this bridge as a portion of its through line. Passengers and freight from the east were disembarked at Council Bluffs and transported across the bridge on dummy trains, to be again transferred at Omaha. The railroad company considered Omaha as the terminus of its line and continued to subject passengers and freight to the inconvenience of this unnecessary double transfer.

Legal proceedings were instituted to compel the company to make up its through trains at Council Bluffs instead of at Omaha. The matter came eventually before the United States Supreme Court. In 1876 the case was decided against the Union Pacific, and the company was ordered to operate its road as one line from Council Bluffs west.²⁶

²⁵ The exact spot designated was "on the western boundary of Iowa east of and opposite to the east line of section 10, in township 15, north, of range 13, east of the 6th principal meridian, in the Territory of Nebraska." (See James Richardson, *Messages and Papers of the Presidents*, Vol. VI, pp. 200, 234.)

²⁶ *Union Pacific Railroad Company v. Hall*, 91 U. S. 343; 23 L. Ed. 428.

Policy of the Union Pacific Coal Department

After the Wyoming Coal Company contract was abrogated in 1874,²⁷ the Union Pacific mined its coal through its own coal department. The company enjoyed a practical monopoly of the coal business along the line of its road. Against other coal producers who owned mines in Wyoming the railroad company made heavy discriminations. The cost to the company of mining coal in 1874 was slightly over \$2 a ton. This figure was greatly reduced before 1880. The government directors, in their report for 1874, published the following figures illustrating the policy of the company in relation to its commercial coal operations:²⁸

STATIONS	RATE AT WHICH U. P. COAL WAS SOLD	TRANSPORTATION CHARGED OTHER PRODUCERS
Omaha	\$9.00	\$10.00
Papillion to Gibbon.....	8.50	11.00
Kearney to North Platte.	8.00	9.50
Cheyenne	7.00	6.00
Laramie	6.50	4.75
Ogden	6.50	10.00

These figures speak for themselves without further comment. Very general dissatisfaction at the company's methods was expressed by persons living along the line of the road who were dependent upon the Union Pacific for their coal.²⁹

Union Pacific's Claims of Exemption from State Taxation

The third matter, the company's attitude toward state taxation, requires a somewhat fuller discussion. The acts of 1862 and 1864 are silent regarding the taxation of the property of the Union Pacific Railroad by states through which the road runs. When these acts were passed, no part of the proposed line was included within the borders of any state.

²⁷ See *supra*, p. 44.

²⁸ The report is published as Sen. Exec. Docs. No. 3, 43rd Cong., 2nd sess. (serial No. 1629, p. 6).

²⁹ Testimony taken by the Cullom Committee in 1886, and by the Pacific Railway Commission in 1887.

In 1867 Nebraska was admitted to the Union. About two years after its admission the new state, on February 15, 1869, passed a revenue law which placed a tax upon the road-bed and right of way of the Union Pacific.³⁰ The local authorities thereupon proceeded to assess the road-bed and right of way at a valuation of \$16,000 a mile. The railroad company opposed this tax and filed a bill in the United States Circuit Court for the District of Nebraska, asking the court to enjoin its collection. Upon the circuit court's refusal to interfere in its behalf, the company appealed to the United States Supreme Court.

The railroad company's contention was that its property was exempt from state taxation by virtue of the fact that it had been chartered under the laws of the United States for the purpose of performing duties of a public character for the government. Counsel for the company argued that its charter endowed it with its franchises, powers, and property as a means or agency for the execution of certain of the enumerated powers vested in the general government, as, for example, the power to establish post roads, the power to maintain an army, and the power to regulate commerce. The Supreme Court had decided at different times, notably in the celebrated case of *McCullough v. Maryland*,³¹ that the means, agencies, and instruments created by the federal government for the exercise of its powers were exempt from state taxation. The Union Pacific Railroad claimed that it was such an agency. It took the position that it was liable to state taxation only to such an extent as Congress should expressly assent to, and concede to the state as being consistent with the safety and efficiency of the company as such means or agency.

The state contended on the other hand that the states of the Union possessed the power of taxing, subject to no limitations of the federal constitution. It was argued that the only

³⁰ Laws of Nebraska, 1869, p. 179.

³¹ 4 Wheaton 316; 4 L. Ed. 579.

exception to this rule was the restriction which forbade a state from assessing a tax against a necessary instrumentality of the federal government; but that not every agency of the United States Government was exempt, as, for example, the stage-coach, the steamer, and the state-incorporated railroad rendered constant service to the government and yet by common consent they were not exempt from state taxation. Taxation which does not impair or interfere with the agent's efficiency was, it was argued, authorized under the Constitution; and a state tax was said to become invalid only when it was levied upon the agent's operations in discharging its functions.

The state argued further: To say that a railroad which was used no more, or was not likely to be used more than any other land grant road sustained any such intimate relation to the federal government as a national bank, was unreasonable. That the Union Pacific was incorporated under a federal statute was but a factitious circumstance; if the Union Pacific were exempt from taxation because of its character as an agent of the federal government, all other railroads should likewise be exempt for the same reason. The Union Pacific Railroad was a private corporation formed for private gain; and such relations as it might have with the government were incidental, and its duties and liabilities to the government were no different from the duties and liabilities of other roads.

The case was argued before the Supreme Court late in the fall of 1873. On December 15 of that year the court decided that the property of the Union Pacific Railroad, although the corporation was an agent of the general government, designed to be employed and actually employed in the legitimate service of the government, both military and postal, was not exempt from state taxation. No constitutional implications, said the court, prohibit a state tax upon the prop-

erty of an agent merely because it is the property of such agent.³²

State Taxation of the Land Grant

The right of way, track, and rolling stock of the Union Pacific Railroad Company were therefore declared subject to state taxation. The extent to which the land grant was subject to state taxation became a separate issue which was decided early in 1875. In 1872 the local authorities in Nebraska levied an assessment upon so much of the company's land grant as lay within that state. This tax the company refused to pay. The authorities were about to seize some of the company's rolling stock under a tax warrant, when the company asked the United States Circuit Court to enjoin these proceedings. The company claimed that its land grant was exempt from taxation for the following reasons:

First, because under the theory of the so-called "contingent right of pre-emption" of the government, the land grant was not subject to taxation. The act of 1862 provided that:

All such lands, so granted by this section, which shall not be sold or disposed of by said company within three years after the entire road shall have been completed, shall be subject to settlement and pre-emption, like other lands, at a price not exceeding one dollar and twenty-five cents to be paid to said company.

The company contended that if its lands were taxable they were subject to a sale for taxes. Such a sale would operate to defeat this contingent right of pre-emption. In a similar suit involving the land grant of one of the other Pacific railroads, the Kansas Pacific, the Supreme Court of the United States had held that:

When Congress declared that if the company did not sell those lands within a time limited by the Act they should then be open to pre-emption and sale, they cannot be withdrawn

³² *Union Pacific Railroad Company v. Peniston*, 18 Wall. 5; 21 L. Ed. 787.

from pre-emption and sale by a tax title and possession under it.³³

Second, because, if the court's former decision in regard to the contingent right of pre-emption should not be upheld, in any case unpatented lands, title to which had not yet legally passed to the company, were not subject to state taxation. By the act of 1864 it was provided that:

Before any land granted by this act shall be conveyed to any company or party entitled thereto, under this act, there shall first be paid into the treasury of the United States, the cost of surveying, selecting, and conveying the same, by said company or party in interest, as the titles shall be required by said company.

This provision requiring the payment of certain nominal fees before full title would vest in the company had been complied with only to a very limited extent. The company had generally applied for patents only as fast as it sold its lands, and it contended that lands to which its title was not yet clear could not, under the ordinary principles of law, be subject to taxation. Moreover, until 1874 patents to one-half the land grant were withheld by the government to insure the full performance of the recommendations which were made in 1869 by the "eminent citizens."

The state of Nebraska on the other hand contended that the entire land grant was subject to taxation. The state's position with reference to the contingent right of pre-emption was that the company's land grant mortgage was a "disposal" of its lands within the meaning of the statute, and therefore that this contingent right of pre-emption no longer existed. The title of the company had been absolute for the purpose of executing this mortgage, and the company had not been hampered by this contingent right. The lands should therefore be subject to taxation, unless the unpatented lands were

³³ *Kansas Pacific Railroad Company v. Prescott*, 16 Wall. 603; 21 L. Ed. 373.

declared exempt by reason of the non-issuance of patents conveying title to them.

The state contended further that if the company had an equitable right to the lands they were subject to taxation, whether patents had been issued or not. The company had earned its lands, and apart from its failure to pay certain nominal fees its right to obtain patents was complete. Whether patented or not, the lands had been available. Both patented and unpatented lands alike had been mortgaged. In many cases lands had been sold before patents had been issued to the company. Unpatented lands had been just as available to the company for all practical purposes as patented lands, and should be subject to taxation.

The circuit court decided that lands which were already patented were subject to taxation, but that lands for which patents had not yet been issued and legal title to which still remained vested in the government were exempt. Both parties thereupon appealed to the United States Supreme Court. The decision of the Supreme Court was handed down on January 18, 1875. This court held, "on fuller argument and more mature consideration," that the theory that the land grant was exempt from taxation on the ground of the contingent right of pre-emption was not tenable. After obtaining title the company exercised all rights of ownership and could claim no exemption from taxation. The court held, however, that with regard to the taxing of unpatented lands the case was otherwise. The company did not obtain even an equitable title, nor did the United States part with its interest in the lands until the required fees had been paid and all other necessary conditions precedent had been complied with. The company had therefore no title to unpatented lands on which it had not paid the costs of surveying and other small incidental fees, and consequently these lands were not subject to taxation.³⁴

³⁴ *Union Pacific Railroad Company v. McShane*, 22 Wall. 444; 22 L. Ed. 747.

The effect of this decision was to place a premium upon failure to comply with the requirements for obtaining patents. The company was able to avoid the state tax by applying for patents only as fast as its lands were sold.³⁵ Many acres of valuable land were thereby exempted from taxation. The railroad company was enabled to hold a great land grant, to sell it, or to mortgage it according as its interests might direct, and yet not be required to pay taxes upon its grant.

In 1886 the total grant to the Union Pacific was estimated to be:³⁶

STATE	ACRES GRANTED	ACRES SELECTED DOWN TO MAY 26, 1886
Nebraska	4,853,844	2,495,659.56
Colorado	590,000	640.00
Wyoming	5,016,000	79,682.03
Utah	850,000	40,196.49
Total	11,309,844	2,616,178.08

The above figures do not include the land grant of the Kansas Pacific Railway Company, which was consolidated with the Union Pacific in 1880. The government directors reported that the company estimated the value of its lands which were still unsold at the close of the year 1883 as follows:³⁷

Agricultural lands, 600,000 acres at \$3.....	\$ 1,800,000
Grazing lands, 7,700,000 acres at \$1.....	7,700,000
Coal lands, 400,000 acres at \$20.....	8,000,000
Total.....	\$17,500,000

In this estimate coal lands are figured at the price at which the government sold coal lands. According to the government directors' report for 1883, their value, both present and prospective, far exceeded the government price.

A subsequent decision of the Supreme Court upheld the company's right to disregard the pre-emption clause of the act

³⁵ Pac. Ry. Com. Test., p. 1240, testimony of Traffic Manager Kimball; p. 1021, testimony of McAllister.

³⁶ *Ibid.*, pp. 4250 ff. letter of Land Commissioner Sparks to Secretary of the Interior Lamar (above figures on pp. 4252, 4257).

³⁷ The report is printed as House Exec. Docs. No. 83, 48th Cong., 1st sess. (serial No. 2200) (see p. 44).

of 1862. A man named William H. Platt settled upon the company's land and attempted to exercise the right of pre-emption by tendering the company the pre-emption price of \$1.25 per acre. The company refused to accept his tender. The question was litigated, and on April 21, 1879, the Supreme Court rendered a decision in favor of the company. The court held that the land grant mortgage "was a disposition of the lands mortgaged within the meaning of the statute, and, consequently, that the tract of land claimed by the complainant was not open to pre-emption when he undertook to pre-empt it."³⁸

Competition with the Kansas Pacific; Early Rate Wars

So far the discussion has been confined to the main line of the Union Pacific from Omaha to Ogden. Little mention has been made of the other companies named in the acts of 1862 and 1864. There were four of these companies: the Kansas Pacific, the Central Branch Union Pacific, the Central Pacific, and the Sioux City and Pacific. Of the last two of these four roads, it is sufficient to say that the Central Pacific connected Ogden and San Francisco, and the Sioux City and Pacific connected Sioux City and Fremont, Nebraska, a station on the main line of the Union Pacific. This last-named road has been of little importance so far as the Union Pacific is concerned, and it never really became a part of the through line, as it had been intended it should.

The Pacific Railroad Acts provided that a line from Kansas City and another line from Atchison, Kansas, should meet 100 miles west of Atchison, and proceed to a junction with the Union Pacific at the hundredth meridian, that is, near Fort Kearney. These two proposed lines from Atchison and Kansas City were respectively the Hannibal and St. Joseph Railroad, which was later known as the Central Branch Union Pacific Railroad Company, and the Leavenworth, Pawnee and West-

³⁸ *Platt v. Union Pacific Railroad Company*, 99 U. S. 48; 25 L. Ed. 424.

ern Railway Company. The name of the Leavenworth, Pawnee and Western road subsequently became the Union Pacific Railway, Eastern Division, and still later, the Kansas Pacific Railway Company.

Later, in 1866, Congress passed an act which permitted the Union Pacific Railway, Eastern Division, then, that is to say, in 1866, known as the Kansas Pacific Railway Company, to change its route and build from Kansas City to Denver, and to form a junction with the Union Pacific main line at a point not more than 50 miles west of the meridian of Denver.³⁹ This company received the same land grant as the other Pacific roads, but its bond subsidy was not extended beyond the first 394 miles, the approximate length of the originally proposed line from Kansas City to the intersection of the Union Pacific with the hundredth meridian, near Fort Kearney.

The Central Branch road was therefore left without a connection with the Union Pacific. Its line was built from Atchison west for 100 miles and there it stopped. Its management, it seems, attempted to secure a subsidy for extending the line, but was unsuccessful. The road was not extended and so never became a part of the through Pacific system. Under the provisions of the act of 1866 the Kansas Pacific built its line to Denver. The link from Denver to Cheyenne was built by the Denver Pacific Railroad and Telegraph Company, a subsidiary corporation of the Kansas Pacific. The completion of this line in 1870 connected Kansas City and Cheyenne.

Like the Union Pacific, the Kansas Pacific was built under a number of construction contracts with its own promoters and directors as contractors. The entire line of the Kansas Pacific lay east of the mountains, and its construction did not require any difficult or expensive engineering. Yet it was encumbered with a capitalization nearly as heavy as that of the Union Pacific. Its bonds bore high rates of interest. The average annual interest per mile on the bonded debt of the Union

³⁹ 14 Stat. L. 79.

Pacific was \$3,185.39; the average annual interest per mile on the bonded debt of the Kansas Pacific was \$2,294.71.⁴⁰ The entire line from Kansas City to Cheyenne runs across the open prairie, while one-half of the Union Pacific line passes through mountains and deserts. Since approximately 20 millions out of 70 millions, or two-sevenths of the Union Pacific bonded debt and all of its 36 millions of capital stock outstanding represented water, the above comparison of the relative annual interest charges per mile of the two roads is an interesting comment on the financial policy of the builders of the Kansas Pacific.

So far as it bears upon the history of the Union Pacific, the financial history of the Kansas Pacific will be outlined in a later chapter. Some mention of the earlier relations of the two companies belongs properly in this place. The statement that during the seventies the Union Pacific enjoyed a monopoly of the western transportation business requires some qualification; for the Union Pacific and the Kansas Pacific were competitors for a considerable volume of traffic. By the act of 1862 it had been provided that the different branches of the Pacific railroad were to be operated "as one continuous line." The Union Pacific and the Kansas Pacific formed one continuous physical line, their connection being at Cheyenne. But the two roads were operated by different companies having different interests, and each was a competitor of the other for through business between the Missouri River and Cheyenne.

The Kansas Pacific was dependent upon the Union Pacific for its western outlet. The Union Pacific was not inclined to make through traffic agreements upon favorable terms with a competitor. For some years these two roads were constantly at war over the question of the prorate on through shipments which passed over the Kansas Pacific line and the line of the Union Pacific west of Cheyenne. Traffic from Kansas City to points west of Cheyenne on the line of the Union Pacific

⁴⁰ Pac. Ry. Com. Test., p. 4991, reports of accountants.

moved at the local rate from Kansas City to Cheyenne plus the local rate from Cheyenne to its destination. Through business passing over the main line of the Union Pacific from Omaha to the same points west of Cheyenne generally enjoyed through rates from Omaha to its destination. The Union Pacific management refused to prorate through rates with the Kansas Pacific; so that any reduction in the through rate which the Kansas Pacific might wish to make in order to meet the competition of the line from Omaha to Cheyenne was borne by the Kansas Pacific alone.

During the entire period of its history as an independent line the Kansas Pacific Railway was hopelessly insolvent. Although the competition of the Union Pacific and its refusal to prorate through rates had an injurious effect upon the Kansas Pacific, the desperate financial situation of the latter road was due mainly to its excessive capitalization and to poor management; but its officials attributed its condition to the refusal of the Union Pacific to prorate the rates on through shipments. In 1874, the vice-president of the Kansas Pacific, Adolphus Meier, memorialized Congress, asking for federal legislation to compel the Union Pacific to prorate. The discrimination which, according to Mr. Meier, was so ruinous to the Kansas Pacific may be understood from a few figures in his memorial:⁴¹

FREIGHT RATES ON THREE CLASSES OF FREIGHT
(In cents per hundred pounds)

	1ST CLASS	2ND CLASS	3RD CLASS
Through rate, Omaha to Ogden.....	250	207½	165
Local rate, Cheyenne to Ogden.....	219	191	163
Difference on which to predicate Kansas Pacific rates	31	16½	2

PASSENGER RATES

	1ST CLASS	EMIGRANT
Through rate, Omaha to Ogden.....	\$54.00	\$21.60
Local rate, Cheyenne to Ogden.....	46.50	46.50
Difference	7.50	.....

⁴¹ Sen. Misc. Docs. No. 54, 43rd Cong., 1st sess. (serial No. 1584). It is not improbable that there are some inaccuracies in Mr. Meier's figures.

The Union Pacific was not at that time in good standing in Congress. The Credit Mobilier investigations of the year previous were still fresh in the minds of members, and the Kansas Pacific interests found Congress in a receptive mood. The desired legislation was obtained. The act of June 20, 1874, required the Union Pacific to afford other roads included in the Pacific Railroad Acts "equal advantages and facilities as to rates, time, and transportation without any discrimination of any kind in favor of or adverse to, the road or business of any or either of said companies."⁴²

This act did not bring to the Kansas Pacific the desired relief. The Union Pacific evaded it and continued to discriminate against its rival, notwithstanding the act. Litigation likewise brought no satisfaction to the Kansas Pacific. The latter road attempted to bring the Union Pacific to terms by rate-cutting, and in 1874 there was a rate war between the two companies. Apparently some sort of truce was reached for a time in 1875, for the Union Pacific report for that year mentions the establishment of harmonious relations with the Kansas Pacific.⁴³ This harmony, if indeed it existed at all, was short-lived. Fierce competition and mutual recrimination continued for several years more. The completion, in 1877, of the Colorado Central, a subsidiary of the Union Pacific, from Cheyenne to Denver enabled the Union Pacific to compete for the Colorado traffic. Competitive rates were always low. It is said that at one time during a 6 weeks' rate war in the early spring of 1878 the Union Pacific carried Colorado passengers for less than the sleeping car fares between the points affected by the low temporary rates. As the Kansas Pacific, which was in the hands of a receiver after 1874, made no serious attempt to meet its fixed charges, its officers could cut rates to a point where the road's income would be sufficient only to meet operating expenses.

⁴² 18 Stat. L. 111.

⁴³ Annual Report of the company for 1875, p. 3.

Gould Control of Both Roads

This competition between these companies continued until some time in the year 1878. It could have only one effect so far as the stock and bond values of the Kansas Pacific were concerned. The securities of the Kansas Pacific dropped lower and lower. The inference that must be drawn is that Gould dictated the Union Pacific's policy toward the Kansas Pacific in order to injure that road and depress its securities, and so make it easier for him to obtain control of it. Whether or not this was his purpose, the fact is that in 1878 he began investing heavily in the Kansas Pacific's depreciated securities. His first purchases were of bonds, but later he and several other Union Pacific directors acquired, at prices in the neighborhood of 12½ cents on the dollar, a controlling interest in the 10 millions of Kansas Pacific stock which was outstanding.⁴⁴ Sidney Dillon, the president of the Union Pacific, then became president of the Kansas Pacific as well.

The personal connection with the Kansas Pacific of the men who were in control of the Union Pacific now established friendly relations between the two roads. A pool was agreed to, under the terms of which the two companies were operated in harmony with each other. Competitive business was divided between the two companies according to the following ratio:⁴⁵

	PER CENT
Union Pacific main line.....	72.858
Union Pacific, Omaha bridge.....	02.776
Colorado Central	04.673
Kansas Pacific and Denver Pacific.....	19.693

This pooling agreement continued in force until the two roads were consolidated, in 1880. The events which brought about this consolidation and the circumstances under which it was effected form the subject of a later chapter.

⁴⁴ Pac. Ry. Com. Test., p. 1695, testimony of John P. Usher; pp. 460 ff., testimony of Gould. Gould's testimony as to the manner in which he obtained control of the Kansas Pacific is, as might have been expected, indefinite and evasive.

⁴⁵ Report of the Government Directors for 1878 (serial No. 2336, p. 152).

CHAPTER VI

DISPUTES AND LITIGATION OVER THE INTEREST QUESTION

Obligation to Repay Interest on Subsidy Bonds

By the fifth section of the act of 1862 it was provided that :

. . . . to secure the repayment to the United States, as hereinafter provided, of the amount of said bonds so issued and delivered to said company, together with all interest thereon which shall have been paid by the United States, the issue of said bonds and their delivery to said company shall ipso facto constitute a first mortgage on the whole line of railroad and telegraph, together with the rolling stock, fixtures, and property of every kind and description, and in consideration of which said bonds may be issued.

The words "as hereinafter provided" refer to the retention of the companies' earnings on government transportation, and to the clause which required the companies to pay annually to the government 5 per cent of their net earnings, it being intended that these two sums be applied toward the extinguishment of the companies' debts to the United States.

Did this provision intend that the company was to pay the interest as it fell due semiannually, or was the provision to be interpreted as allowing the company to defer its interest payments until the bonds matured?

The debates in Congress over the passage of the act of 1862 indicate that it was expected that the company's annual earnings from government transportation would more than suffice to meet the semiannual interest as it fell due. This expectation was not entirely groundless. According to figures submitted to Congress by the Secretary of War, between the years 1857 and 1861 the cost of transportation of troops and

munitions of war alone upon the western plains averaged over \$2,000,000 annually, and in one year, 1859, amounted to over \$4,250,000.¹ It may be possible that in these figures many large items were not taken into account which should have been taken into account; for the statement was made by one member of Congress that the total cost of western army transportation alone was in the neighborhood of \$6,000,000 a year.² It was estimated that western postal service cost the government \$1,500,000 additional. The cost of transporting such naval supplies as were carried overland during these five years is said to have averaged \$48,351.08 a year.³ On the other hand, the entire interest which the United States was to pay upon the subsidy bonds to be issued under the act of 1862, including interest on a proposed bond issue which was never made for a line from Sacramento to Portland, Oregon, was estimated at \$3,892,080 annually. Moreover, the prevailing opinion was that for many years the Union Pacific and Central Pacific would be the only transcontinental railroad, and would therefore control the entire western traffic.

When the act was passed the question of repayment was a relatively unimportant consideration. Nevertheless there were a few congressmen and senators who raised the issue. Some of the members declared that the government could not and should not expect repayment; while others demanded that some definite provision be made one way or the other, lest the payments to be made under the transportation and 5 per cent clauses above referred to should fall short of meeting the semiannual interest on the bonds. One member of Congress expressed the opinion that it was not necessarily desirable that the interest should be repaid; but that it was a primary consideration that the rates of fare be moderate.⁴ A proposed amendment to require repayment by the companies of the

¹ House Exec. Docs. No. 80, 37th Cong., 2nd sess. (serial No. 1135).

² Cong. Globe, 37th Cong., 2nd sess., p. 1578.

³ *Ibid.*

⁴ *Ibid.*, p. 1891.

semiannual interest within 30 days after it had been paid by the government was voted down.⁵ Apparently the supposition was that the transportation of government supplies over the road would equal, if not greatly exceed, the semiannual interest. One member of the House of Representatives said:

It is the intention of the bill that the interest shall be paid semi-annually to the Government in transportation; but if the transportation does not meet the interest, then the Government is to have a mortgage on the entire road for the full amount of principal and interest.⁶

Early Congressional Debates over Interest Repayment

After the road was completed, its annual receipts from government transportation were found to be entirely inadequate to repay the interest on the bonds as it became due. The company's earnings from this source fell far below the figures of previous estimates. Railroad rates were very much lower than the rates which had formerly been paid by the government for transportation. The necessity for maintaining forts and troops to police the plains disappeared rapidly after the railroad was built, for upon the completion of the railroad the problem of Indian outbreaks ceased to be serious. It was therefore no longer necessary for the government to expend large sums for transportation in the course of its campaigns against hostile tribes. The railroad's earnings from government transportation, even at the relatively high tariff rates which then prevailed, repaid but a small portion of the semiannual interest on the subsidy bonds.

It was not long before the road's annual shortage attracted the government's attention. Government officials and members of Congress began to wonder if the government would ever receive back its money. The early sentiment which had demanded a railroad at any price disappeared after the road was built, and after the Credit Mobilier investigations many

⁵ *Ibid.*, p. 1911.

⁶ *Ibid.*, p. 1912.

people began to look upon the Pacific railroads as great corporate absorbers of public property.

In December, 1870, the Attorney-General of the United States decided that the Pacific railroads were legally bound to repay this interest semiannually as it accrued, and that by reason of their failure to do so they were defaulting debtors to the United States government.⁷ Relying on this opinion of the Attorney-General, Secretary of the Treasury Boutwell made an attempt to collect a portion of this unpaid interest by issuing an order that thereafter the entire sum, and not, as theretofore, one-half of the sum due to the companies for services performed for the government be withheld. Down to July 1, 1870, the government had made interest payments aggregating \$3,713,371.05 upon the bonds issued to the Union Pacific; and of this amount the Union Pacific had repaid but \$1,289,576.87.⁸

In February, 1871, when the Army Appropriation bill was before the Senate, Senator Stewart, of Nevada, proposed a "rider" directing the Secretary of the Treasury to repay to the several companies the amounts he had withheld. This proposed amendment conformed with a report which the Judiciary Committee of the Senate submitted to the Senate on February 24, 1871. This committee reported that the companies were under no legal obligation to repay interest on the subsidy bonds until the maturity of the bonds, and that the Secretary of the Treasury had exceeded his authority in retaining more than one-half of the compensation due the companies on government account.⁹

This Senator Stewart was the same senator who had two years previously made an attack on the Union Pacific management, and who had charged its builders with having defrauded the government out of many millions of dollars through the

⁷ 13 Atty. Gen. Ops. 361.

⁸ Report of the Secretary of the Treasury for 1872, pp. 41, 42, House Exec. Docs. No. 2, 42nd Cong., 3rd sess. (serial No. 1582).

⁹ Senate Report No. 375, 41st Cong., 3rd sess. (serial No. 1443).

Credit Mobilier. Stewart was a representative of the Central Pacific's interest. He had made his former attack upon the Union Pacific because it was in the interest of the Central Pacific to do so. Now in the interest of the Central Pacific he proposed the above amendment to the Army Appropriation bill.

Stewart's proposed amendment resulted in a long debate. Both the Union Pacific and Central Pacific roads were at this time somewhat embarrassed financially, and it is extremely doubtful whether either one of them could have met the interest on the government subsidy bonds in addition to paying their own interest obligations upon their excessive bond issues. Senator Stewart had so worded his amendment that its effect would be to preclude the United States from ever attempting to collect this interest, even after the companies might become able to meet it. There was force to the argument that in view of the great national benefits which resulted from the road's completion, equity and justice demanded that the government should voluntarily forego its legal rights so long as the companies were still poor; but to do this it was entirely unnecessary that the government should permanently surrender its right to bring suit for the recovery of this money at some future time when the companies might be well able to pay. Senator John Sherman, of Ohio, urged that the government retain at least the right to sue for such interest as might be in arrears. He proposed the following amendment:

But nothing contained in this section shall be held to affect, change or impair the legal right of the United States to the repayment by such railroads of the interest paid by the United States, but that the legal rights of all parties in respect to said interest shall be determined by previously existing law.¹⁰

The merits of the case were thus summarized by Senator Sherman:

¹⁰ Cong. Globe, 41st Cong., 3rd sess., p. 1778.

Let the men engaged in this enterprise enjoy whatever prosperity they have growing out of it. I do not wish on that account to surrender a legal right on the part of the United States to reclaim this interest when the companies are able to pay it; and I say that as a question of moral ethics, as between the companies and the United States, the companies are bound to pay us back the interest as soon as they are able to do it.¹¹

Senator Sherman's proposal in a somewhat modified form was incorporated into the Stewart amendment. Although the Sherman amendment was voted down, the following clause was adopted at Sherman's suggestion as an amendment to the Stewart amendment: "Provided, That nothing herein contained shall be held to determine the legal rights of the several parties, or give construction to the statute aforesaid, all of which are to be left for future adjudication." The "rider" as thus amended was passed by both houses, and remained in effect for two years.¹²

The interest question was again raised in the following Congress. After the Credit Mobilier disclosures early in 1873, the Pacific railroads had few friends in Congress. The investigations of the Poland and Wilson Committees had convinced members of both houses that if the companies themselves were poor, and hard-pressed to meet their interest obligations, the individuals who owned them, particularly the men who managed the Union Pacific, had made millions out of the construction. At the close of the year 1872 the Union Pacific was over 5½ million dollars in arrears,¹³ and Congress

¹¹ Cong. Globe, 41st Cong., 3rd sess., p. 1782.

¹² *Ibid.*, p. 1874; 16 Stat. L. 525. A powerful lobby assisted the passage of this bill. (See Wilson Report, p. XVII, also testimony of Cornelius Bushnell before the same committee, and that of General Dodge before the Pacific Railway Commission.) The testimony is conflicting, and it is impossible to say whether a sum amounting to \$24,000 was paid by Bushnell to Dodge to procure the passage of this act, or whether it was for Dodge's services in procuring the passage of the act of 1870, which authorized the Union Pacific to issue bonds on its proposed Omaha bridge which were to be a lien superior to the government's lien on the bridge (16 Stat. L. 430), or whether it was paid in the course of a private speculative transaction regarding Union Pacific stock. Dodge says the money represented his profit and Bushnell's loss in the speculation; while Bushnell testified that the sum was paid for Dodge's services in procuring the passage of the Omaha Bridge Act.

¹³ Report of the Secretary of the Treasury for 1873, p. 45; House Exec. Docs. No. 2, 43rd Cong., 1st sess. (serial No. 1603).

felt that the time had come to settle the question of interest payments. In February, 1873, by a "rider" to the legislative, executive, and judicial appropriation bill, Congress directed the Secretary of the Treasury to withhold from the Pacific railroad companies all payments on account of services rendered the government, but authorized any one of the companies to bring suit in the Court of Claims for the recovery of one-half of the amount thus withheld.¹⁴ The question was therefore referred to the courts for settlement.

Court Decision that Interest Not Due Until Maturity of Bonds

Payments were accordingly withheld. The Union Pacific at once brought suit in the Court of Claims to recover one-half of the sum so retained. The government counter-claimed for the amount of interest which had accumulated since the bonds had been issued. The Court of Claims decided against the government, and the case was appealed to the Supreme Court of the United States.

In October, 1875, the Supreme Court affirmed the decision of the Court of Claims.¹⁵ The Supreme Court held that while under the acts of Congress the Union Pacific Railroad was obliged to pay principal and interest of the United States bonds issued to aid its construction at their maturity, the words "at maturity" meant at the maturity of the bonds when the principal fell due. The company was not required to pay each installment of interest as it accrued. Said the court:

The words "to pay said bonds at maturity" imply obviously an obligation to pay both principal and interest, when the time fixed for the payment of the principal has passed; but they do not imply an obligation to pay the interest as it accrues, and the principal when it is due. . . . It is necessary to superadd other words in order to extend the condition so as to include the payment of semi-annual interest

¹⁴ Cong. Globe, 42nd Cong., 3rd sess., pp. 826 ff.; 17 Stat. L. 508.

¹⁵ *United States v. Union Pacific Railroad Company*, 91 U. S. 72; 23 L. Ed. 224.

as it falls due. Neither on principle or authority is such a plain departure from the express letter of the statute warranted.

The language of the statute is not explicit. The law was carelessly drawn. It was passed at a time when the problems of the war demanded constant attention, and when details were not likely to be closely scrutinized. It may be that Congress intentionally left the act obscure in order to postpone settlement of this question until later. The Supreme Court's decision settled the question in so far as the legal side was concerned. The court's interpretation was in entire accord with the language of the statute strictly construed. The statute contains no provision requiring the company to repay the annual interest as it accrued, according to the tenor of the bonds.

Commencing on July 1, 1875, the company for ten years distributed large annual dividends, and each year the surplus remaining after the payment of these dividends fell very far short of the sum which would have been needed to pay the interest on the government subsidy bonds. This was a wholly unjustifiable diversion of the company's property from the company's largest creditor, the government, to the stockholders. This corporation, which maintained a dividend rate of 6, 7, and 8 per cent per annum upon stock which had originally been issued as a gratuity should have met its interest obligations to the government. Even if the justice of allowing the company to postpone payment of the interest until the bonds matured be conceded, considerations of ordinary moral ethics required the company to make some adequate provision, by way of sinking fund, or otherwise, for the ultimate redemption of the principal and interest, instead of allowing the debt to accumulate while at the same time it was distributing its earnings as dividends.

That the debt, both principal and interest, would ultimately

become due and payable the company's officers admitted. That the company would in all probability be unable to meet this enormous debt at maturity seemed also perfectly obvious to everyone and was admitted by the company. What might happen twenty or thirty years in the future was of small concern to the men who were then in charge of the road. If we are to judge from outward manifestations and from results, Gould's policy was to obtain the largest immediate return possible, and then to withdraw from the company while there was still time. This purpose was assisted by the careless manner in which the statute incorporating the company was drawn; so that it was possible to postpone the payment of the road's interest obligations to the government for over twenty years and thereby increase the sums available for immediate distribution.

The "Net Earnings" Case

The joint resolution of April 10, 1869, which fixed the junction of the Union Pacific and Central Pacific at Promontory, Utah, had provided for a commission of five "eminent citizens" who were to examine and report upon the physical condition of the roads, and whether the roads had complied with the clause in the statute requiring them to be "first-class roads." On October 30, 1869, the "eminent citizens" had reported that certain additional expenditures would be necessary before either road could be classed as a first-class road. In order to insure performance of the recommendations of the "eminent citizens," the Secretary of the Interior ordered that the government withhold patents to one-half of the land grant until the companies had remedied the deficiencies which had been reported.

Another commission was appointed in 1874 to examine both roads and to report whether the companies had complied with the recommendations of the earlier commission. In the fall of that year the new commission reported that "the road

was completed as required by law, by the report of the former commission, and to comply with the instructions of the Interior Department, October 1, 1874." The Secretary of the Interior, Mr. Delano, now recommended that the order withholding land patents be revoked. This order was accordingly revoked by President Grant on November 5, 1874.¹⁶

The act of 1862 contains the following clause relative to net earnings: "After said road is completed, until said bonds and interest are paid, at least five per centum of the net earnings of said road shall also be annually applied to the payment thereof." But when was the road "completed," and what are "net earnings"?

The United States government claimed that the Union Pacific was completed when the last subsidy bonds were issued July 15, 1869.¹⁷ Under this interpretation the company was liable for 5 per cent of its net earnings between 1869, the year when the last subsidy bonds were issued, and 1874. The railroad company, however, claimed that the government's refusal to issue patents for a portion of the land grant until the road had been completed according to the standard set by the "eminent citizens" was an admission by the government that the road was not a "completed road" at the time of their report. The second commission had reported that the Union Pacific was completed according to the Government's requirements on October 1, 1874, and the company insisted that this date was in fact the date of the road's completion; although regular through trains had been running on its line ever since May, 1869.

In one sense it may be questioned whether a railroad is ever completed. Repairs, renewals, improvements, and new construction are constantly necessary. The Union Pacific Railroad was sufficiently completed in 1869 to permit the company to receive the entire bond subsidy, and as each 20-mile section

¹⁶ House Misc. Docs. No. 132, 44th Cong., 1st sess. (serial No. 1702), p. 10, footnote.

¹⁷ *Ibid.*, p. 10.

of the road was constructed, the company's officers made affidavit that the section was completed according to the requirements of the law. Between 1869 and 1874 the company made applications for some of the land patents which had been withheld; and when the road's managers asked the government to issue land patents they declared that their road was completed. On the other hand, they contended that the road was not completed within the meaning of the law which required it after completion to pay 5 per cent of its annual net earnings to the government.

There was an inconsistency in the government's position as well. The lands had been withheld to insure the road's "completion." At the same time the government sought to collect 5 per cent of the company's net earnings during a period when, according to the report of a government commission, the road was not a "completed road." This apparent inconsistency must, however, be considered in connection with the fact that the company's land grant mortgage covered the entire grant, patented and unpatented, and by the fact that the company had already received patents for as many lands as it could conveniently dispose of. The company suffered no serious inconvenience by reason of its inability to obtain patents to the entire grant until after 1874.

The date of the road's completion was not the only question upon which the company and the government failed to agree. This apparently simple clause in the statute which required the company to pay annually 5 per cent of its net earnings into the United States Treasury failed to define net earnings. By what calculation is the amount of a corporation's net earnings to be ascertained? To arrive at net earnings is it proper to subtract fixed charges, that is, interest on the company's funded debt, from the sum which remains after the operating expenses have been paid? Or, since the net earnings clause in the act of 1862 was a provision for the partial liquidation of the government's second mortgage,

would it be proper, in order to ascertain the amount of the Union Pacific's net earnings which was subject to this statutory provision, to deduct only the annual interest on the first mortgage, and not to subtract interest on mortgages subordinate to the government's lien? Or does the phrase "net earnings" denote the entire sum which remains after paying operating expenses? What new construction is properly paid for out of earnings and what may be properly charged to capital? Did net earnings in this case include the half-earnings on government transportation which the government withheld? Were the receipts from land sales to be taken as earnings and so made subject to the provision of the law, and should the expenses incidental to the company's land department be considered as a part of the operating expenses?

The litigation growing out of the Pacific Railroad Acts of 1862 and 1864 furnishes excellent illustration of the complications and disputes which so frequently result from the failure of legislators to define terms and word important clauses so as to leave no opportunity for doubtful interpretation.

It required the decision of the Supreme Court of the United States to determine the date of the completion of the Union Pacific Railroad, and to determine what was meant by the term "net earnings." A suit commenced by the government in the Court of Claims to decide these questions came eventually before the United States Supreme Court, in 1878. On January 27, 1879, the court decided this case—commonly known as the "net earnings" case—in favor of the government's contentions on all principal points.¹⁸

The court held that the road was completed for the purpose of this 5 per cent payment when it had been so reported by the company and accepted by the government for the purpose of issuing the subsidy bonds, even though its acceptance had been provisional and security had been required for remedying deficiencies in its construction. Since the company had from

¹⁸ *Union Pacific Railroad Company v. United States*, 99 U. S. 402; 25 L. Ed. 274.

time to time declared sections of the road complete as the work progressed, and inasmuch as it had received the subsidy bonds to be issued upon its completion, it was estopped to deny that the road was completed. Therefore the company was liable for 5 per cent of its net earnings during the years from 1869 to 1874. Five per cent of the aggregate net earnings during these years amounted to \$1,040,056.29, and judgment for this sum was rendered in favor of the government.

The term "earnings" was declared by the court to include all the receipts of the company arising from its operations as a railroad. Receipts from land sales were not to be included, nor fictitious receipts from the transportation of its own property. The net earnings of a railroad corporation, the court held, are to be ascertained by deducting from the gross earnings all ordinary expenses of organization and of operating the road, and all expenditures made bona fide in improvements which are paid for out of earnings and not by the issue of bonds or stock. To arrive at net earnings, interest on the bonded debt should not be deducted, as such interest is more in the nature of a dividend upon the capital invested. The court held, however, that as the government's lien was subordinate to that of the first mortgage bondholders, interest upon the first mortgage took precedence of the government's claim for 5 per cent of the road's net earnings; so that if in any one year the net earnings should be insufficient to pay both the interest on the first mortgage and also to meet the government's 5 per cent requirement, the government would be entitled only to the sum remaining after interest on the first mortgage had been paid in full.

The court disallowed the company's claim to have the following specific items subtracted from the gross earnings in order to arrive at the net earnings (the figures indicate the amounts expended for the purposes specified from November 6, 1874, to November 5, 1875):¹⁹

¹⁹ *Union Pacific Railroad Company v. United States*, 99 U. S. 402, at pp. 418 ff.

Discount and interest upon the floating debt.....	\$ 61,545.17
Expenses of land and town departments.....	141,482.34
Taxes on lands and town lots.....	109,773.68
Interest on bonded debt.....	3,392,392.26
Premium on gold to pay coupons.....	301,786.53
Sinking fund requirements to extinguish:	
Omaha bridge bonds.....	47,000.00
Sinking fund mortgage bonds.....	144,000.00
Premium on Omaha bridge bonds redeemed.....	12,513.32
U. S. interest half transportation accounts.....	358,193.39
Total.....	<u>\$4,628,686.69</u>

The court held that items of expense for permanent improvements such as the following were properly chargeable to earnings; station buildings; shops and fixtures; equipment; fencing; snow sheds; engineering; bridging; car shops; sheds; roadway and track; hotels; tenements; coal sheds; Omaha depot and general offices; real estate; water works; and the company's rolling mill at Laramie.

From a superficial view it would seem that a company's net earnings afford the fairest criterion for estimating its ability to pay taxes. The history of the Union Pacific has, however, demonstrated the impracticability of this theory. A thorough trial showed the weakness of this arrangement whereby the government levied upon the company an annual contribution, the amount of which was to be fixed according to a percentage system based on the net earnings. The decision of the Supreme Court in the net earnings case settled a number of points in dispute; but it by no means put an end to disagreements and litigation over this subject. As will be seen later on, this net earnings clause resulted in continual disputes as fresh questions arose from time to time.

Growing Debts of the Pacific Railroads

The Supreme Court's decision in the interest case, in 1875, freed the Pacific railroad companies from the necessity of paying either principal or interest of their debt to the United

States until the subsidy bonds matured. After this decision was announced, the question naturally arose whether the companies would meet their obligations to the government when this debt became due. In 1875 it was but twenty years before the first of the bonds would mature. Men who were conversant with the business methods, policy, and financial condition of the different Pacific railroad companies had good reason to doubt the ability of the roads to pay ultimately their rapidly growing debts to the government. The principal of the subsidy bonds issued to the Union Pacific amounted to \$27,236,512. Simple interest on this sum for 30 years at 6 per cent would amount to \$49,025,721.60; so that when the bonds should mature the Union Pacific would owe the government the enormous sum of \$76,262,233.60, except so much thereof as might be reduced by the payment of 5 per cent of the company's annual net earnings, and by one-half of the compensation due the company each year on government account.

Though the company's earnings at this time were large enough to enable it to distribute liberal dividends upon stock which represented no money investment, it was making no voluntary provision for meeting ultimately its debt to the government. In justice to the company it must be said, however, that its president, Dillon, offered, in 1875, to establish in the United States Treasury a sinking fund to retire the company's debt to the government, and to pay toward this fund the sum of \$500,000 annually.²⁰ For some reason this proposition was not accepted by the government; yet nothing prevented the company from establishing of its own volition a sinking fund for this purpose.

This was the only occasion when the company's officials manifested any desire to make provision for the payment of this debt, and with this one exception, their policy throughout

²⁰ Letter of Dillon to the Secretary of the Treasury, printed in the annual report of the company for 1874, p. 30.

seemed to be to get all they could out of the road and then abandon it to a foreclosure sale. The government's lien had been made subordinate to the lien of the first mortgage. Without assuming this prior mortgage, the government could not itself take over the road when the subsidy bonds matured, apart from the considerations of expediency which such a radical step might involve. In the seventies it was believed very doubtful whether a foreclosure sale would bring any more than would be enough to satisfy the first mortgage. Conditions had changed materially from what they were in the sixties. Prices had gone down, and Bessemer steel rails were very much cheaper than the iron rails used in the first construction of the Union Pacific. In the late seventies new roads on the western plains cost no more than about \$25,000 a mile. Jay Gould himself once declared that in 1880 he "could build a road for \$15,000,000 from Omaha to Ogden as good as one that was mortgaged for \$75,000,000."²¹ Gould's statement seems greatly exaggerated; however, it was generally supposed at this time that there was not the remotest possibility that the road could be sold for enough to satisfy both the first mortgage debt of over \$27,000,000 and the \$76,000,000 of principal and interest due the government. If the road should be sold under foreclosure it would probably fall into the hands of first mortgage bondholders. It was rumored that many of the company's officers and prominent stockholders held large amounts of the first mortgage bonds and that these bondholders were deliberately planning to take such steps as would result eventually in foreclosing the government out of its lien. Whether this rumor had any foundation is doubtful, but it seems to have had an effect in shaping opinions on this question.

In 1876 the net earnings question was still in litigation, as well as the government's right to recover 5 per cent of the company's net earnings during the years from 1869 to 1874.

²¹ Pac. Ry. Com. Test., p. 510, testimony of Gould.

The interest which the government paid on the bonds issued to the Union Pacific amounted each year to \$1,634,190.72. Between 1867 and 1875, inclusive, the Union Pacific had in no year repaid more than about one-third of this sum. In one year, 1871, the amount so repaid reached the sum of \$529,025.82, and in two other years, 1868 and 1875, the amount exceeded \$400,000. In 1873, only \$187,621.87 was repaid. During these nine years the government paid out as interest on the subsidy bonds the sum of \$12,701,420, of which the company repaid but \$3,996,779, leaving an unpaid balance of \$8,704,641.²²

This account was extremely discouraging. It was clear that transportation earnings would repay only about one-fourth of the interest and none of the principal. The addition of 5 per cent of the company's net earnings did not greatly improve the situation. The amount which would be repaid under the 5 per cent clause for the entire period from November 6, 1869, to October 31, 1874, if the government won the net earnings case then pending, as it afterwards did, was only \$1,040,056.29.²³ For the years 1874 and 1875 the company's report to the government shows the following figures:²⁴

YEAR	NET EARNINGS	5 PER CENT THEREOF
1874	\$5,156,970.99	\$257,848.04
1875	6,148,365.67	307,418.28

The total amount due the government on the net earnings account from 1869 to 1875, inclusive, was only \$1,399,934.90. The entire amount repaid by the company annually, including both 5 per cent of the company's net earnings and one-half of its earnings from government transportation, averaged only about \$600,000 or \$700,000, or a little over one-third of the annual interest which was paid by the government. Down to

²² House Misc. Docs. No. 132, 44th Cong., 1st sess. (serial No. 1702), p. 8. The exact figures appear unattainable. The table set forth in Sen. Docs. No. 10, Pt. 1, 55th Cong., 1st sess. (serial No. 3359), p. 39, gives somewhat different figures and gives the balance due Jan., 1876, at \$8,621,715.24.

²³ *Ibid.*, p. 14.

²⁴ *Ibid.*, p. 13.

the early spring of 1876 the company had actually repaid less than \$4,000,000.²⁵

The Thurman Act

It was therefore plain that unless something was done immediately, the government was in danger of losing the large sum which would ultimately become due. On March 1, 1876, the House of Representatives passed a resolution directing the Judiciary Committee to inquire into the Pacific railroad situation and to report what legislation was necessary in order to secure indemnity to the United States for its advances to the various Pacific railroad companies.²⁶ The inquiry was conducted by a subcommittee of two members, one a northern Republican, and the other a southern Democrat.²⁷ Their report, which was submitted to the House on March 13, 1876, proposed a bill requiring each of the Pacific railroad companies to pay annually into the United States Treasury toward a sinking fund, such a reasonable sum as the Secretary of the Treasury should deem proper. This sum, which was to be in addition to the amounts to be paid under the existing statutory requirements in regard to transportation and net earnings, was to be invested in bonds of the United States.

Later during the same session, the House, on July 7, 1876, passed a bill embodying these suggestions, by the overwhelming vote of 159 to 9.²⁸ This bill proposed to withhold all transportation earnings and to require the Union and Central Pacific railroads each to pay into the Treasury of the United States the sum of \$750,000 annually for ten years and \$1,000,000 each year thereafter, in addition to the amounts to be paid under the 5 per cent requirement. The annual amounts to be so turned over to the United States were to be

²⁵ House Misc. Docs. No. 132, 44th Cong., 1st sess. (serial No. 1702), p. 8.

²⁶ Cong. Record, 44th Cong., 1st sess., p. 1393.

²⁷ The members of the subcommittee were Representatives Hunton and Lawrence. Both these men were members of the subcommittee which in the same spring investigated James G. Blaine's alleged improper connection with the Union Pacific.

²⁸ Cong. Record, 44th Cong., 1st sess., p. 4465.

invested in United States bonds, interest on this investment to accrue to the benefit of the companies. The bill also prohibited the companies from paying dividends when these annual payments were in default. The sinking fund and its accretions were to be used to pay off the companies' debts to the government when the subsidy bonds should mature.

In the Senate this bill never made any appearance out of the committee to which it was referred; but on July 12, 1876, Senator Thurman of Ohio reported from the Judiciary Committee a substitute bill which differed from the House bill in one important particular.²⁹ Instead of requiring the companies to pay a fixed sum each year, Senator Thurman's bill required the Union Pacific and Central Pacific each to pay annually into the United States Treasury 25 per cent of their net earnings; neither company, however, was to be compelled to pay more than \$1,500,000 in any one year. The retention of the percentage feature was probably designed to enable the government to share in the benefits of the steadily increasing net earnings of each company.

This bill was the subject of many debates in the Senate, but it failed to pass the forty-fourth Congress. Senator Thurman again introduced his bill in the following Congress. After a long debate and some changes it finally passed both houses, and on May 8, 1878, it was signed by President Hayes.

The Thurman Act, so-called, was one of the most important of the numerous statutes which relate to the Pacific railroads. As finally passed it provided, in substance, that:³⁰

1. For the purpose of calculating the companies' annual percentage payments, net earnings were defined as the amount remaining after deducting the necessary expenses of operating, together with the interest on the first mortgage, which was a lien prior to the lien of the government's second mortgage. This definition, it will be observed, differs from the later

²⁹ *Ibid.*, p. 4514.

³⁰ 20 Stat. L. 56.

decision of the Supreme Court in the net earnings case, in which net earnings were declared to include interest on the first mortgage.

2. The entire compensation due the companies for services rendered the government was to be retained. One-half thereof was to be applied toward the liquidation of the current interest, and the other half was to be turned into the sinking fund provided by this act.

3. A sinking fund was to be established in the Treasury of the United States, and was to be invested in bonds of the United States. The income of this sinking fund was to be reinvested in the same manner. In making these investments the Secretary of the Treasury was left to use his own discretion as to which series of United States bonds were to be selected for this purpose.

4. The Central Pacific was required to pay annually toward the sinking fund, \$1,200,000, and the Union Pacific \$850,000, or so much thereof as would make the sum of 5 per cent of the net earnings, plus the amount of transportation retained, plus the additional sum required to be paid under this act, amount in all to 25 per cent of the net earnings of each road. No dividends were to be paid while these annual payments to the government were in default.

The act contained a number of additional provisions providing for the manner of its enforcement and fixing penalties and forfeitures for non-compliance with its requirements. The only companies specifically mentioned in the act are the Union Pacific and the Central Pacific. In 1880, the Court of Claims held that this law did not include the other three Pacific railroad companies in its provisions;³¹ and in 1885, five years after the Union Pacific and Kansas Pacific were consolidated, the same court required only the Union Division that is, the original Union Pacific Railroad, from Omaha to Ogden, to

³¹ *Kansas Pacific Railway v. United States*, 16 Ct. Cl. 373.

comply with the 25 per cent requirement of the Thurman Act, although the court's opinion on this point is not wholly clear.³²

The financial policy of the Union Pacific during the seventies had demonstrated the fact that its officials could not be trusted to make provision of their own accord, by way of a sinking fund or otherwise, for the ultimate payment of the road's increasing debt to the government. The road's surplus earnings which remained after the payment of operating expenses, fixed charges, and such expenses for new construction and branch lines as were paid out of earnings, were distributed among the stockholders. That the Thurman Act should be viewed with favor by the stockholders and directors of the Union Pacific was not to be expected. Immediately after its passage the company attacked its constitutionality, and began legal proceedings to have the law annulled. The company contended that the act contravened four fundamental constitutional rights; the inviolability of vested rights; the obligation of contract; the prohibition against taking private property for public use without just compensation; and the right of a private person not to be deprived of his property without due process of law.³³ As will be seen later on, the Thurman Act proved unsatisfactory in its operation; but this issue had no bearing upon the constitutionality of the act, and was not at this time raised by the company.

The question came finally before the Supreme Court of the United States, in March, 1879. On May 5, 1879, a decision against the company was handed down. The court held that:³⁴

1. The act establishing a sinking fund in the Treasury was constitutional.

2. That act did not deprive the Union Pacific Railroad Company of its property without due process of law or in

³² *Union Pacific Railway Company v. United States*, 20 Ct. Cl. 70.

³³ The two of these restrictions last named are embodied in the Federal Constitution; the inviolability of vested rights was established by the Dartmouth College case. (*Dartmouth College v. Woodward*, 4 Wheaton 518; 4 L. Ed. 629). There is no constitutional inhibition against impairment by the federal government of the obligation of contracts.

³⁴ *Sinking Fund Cases*, 95 U. S. 700; 25 L. Ed. 496.

any other way improperly interfere with vested rights, but was a reasonable regulation promotive of the interests of the public and the corporators alike.

3. The fact that the Secretary of the Treasury was made the sinking fund agent and that these funds were to be invested in United States bonds did not constitute an anticipation of the payment of the debt before due, and therefore contravene the court's previous decision in the interest case; for the fund and its accumulations belonged to the company. All that the act provided was to make it the duty of the company to lay by a portion of its current net income to meet its debts when they should fall due, and in this way prevent the current stockholders from depleting the treasury for their own benefit at the expense of those who should come after them. The act merely compelled the managers to do what they ought to do voluntarily.

Apart from all questions of law, it was obviously demanded by every rule of sound finance, as well as of good morals, that the company should make some provision for meeting its obligations to the government. To be sure a mortgagee has, in equity at least, only a lien upon, and not title to, the property of his mortgagor; and until his debt becomes due, the creditor cannot ordinarily interfere with the debtor's management of his own property. Nevertheless, just as a debtor has no legal right to transfer or give away his property in fraud of his creditor, so he has no moral right to deplete his resources in such manner as to inflict unnecessary loss upon his creditor. The dividend policy of the Union Pacific weakened its treasury and consequently injured the security of its creditors. A lower dividend rate would have enabled the company either to meet its annual interest debt to the government as it accrued, or to make adequate provision by way of a sinking fund for the satisfaction of the debt at maturity.

The question of the practical operation of the Thurman Act is distinct from the question of the government's right

and duty to require the establishment of a sinking fund. The immediate effect of the act was to compel the company to pass one dividend which would otherwise have been payable on July 1, 1878, and to compel it to reduce the next quarterly dividend, in October of the same year, to $1\frac{1}{2}$ per cent. The dividend rate remained at this figure until after the consolidation of the Union Pacific and the Kansas Pacific, in January, 1880.

The Thurman Act did not satisfy either the company or the government. The act retained the unfortunate feature of the earlier acts which made net earnings the basis for determining the company's annual payments to the government. The sinking fund failed to produce the income which had been anticipated, on account of the high premium on government bonds. Consequently a large sum of money was so invested that it yielded only a little over 2 per cent per annum. The Thurman Act served to increase the already existing tendency to friction between the government and the railroad company.

One other factor should be mentioned which tended to increase the mutual antagonism of the government and the company during the decades from 1870 to 1880 and from 1880 to 1890. This was the opportunity which was open to speculators in Congress and out to procure the introduction of bills and resolutions aimed at this railroad company, not for the bona fide purpose of correcting some existing abuse, but in order to depress the value of Union Pacific securities in the stock market, or to levy blackmail. The company had good reason to fear these "bear raids" in Congress, which made the situation more unsatisfactory. A regular lobby was maintained at Washington to take care of such threatened attacks, as well as to forestall the possible passage of bona fide "hostile legislation" on the part of Congress. The general situation was so manifest that Bryce remarked in his "American Commonwealth":

The great commercial companies, and especially the great railroad companies, are often through their land grants and otherwise brought into relations with the Federal Government. Bills are presented in Congress which purport to withdraw some of the privileges of these corporations, or to establish or favor rival enterprises, but whose real object is to levy blackmail on these wealthy bodies, since it is often cheaper for a corporation to buy off its enemy than to defeat him either by the illegitimate influence of the lobby, or by the strength of its case in open combat. Several great corporations have thus to maintain a permanent staff at Washington for the sake of resisting legislative attacks upon them, some merely extortionate, some intended to win local popularity.³⁵

³⁵ Bryce, James, *The American Commonwealth*, London, 1887, Vol. I, p. 151.

CHAPTER VII

THE KANSAS PACIFIC CONSOLIDATION

Financial Insolvency of Kansas Pacific

In 1870 the Kansas Pacific Railway Company, in conjunction with the Denver Pacific Railway and Telegraph Company, had completed its line from Kansas City to Denver, and thence to Cheyenne. Although the entire line of the Kansas Pacific lay east of the mountains, and although its construction did not require difficult or expensive engineering, this road was encumbered with a capitalization of over \$65,000 per mile. This figure is considerably higher than the amount at which the level portion of the Union Pacific was capitalized; it is, however, less than three-fourths of the amount of capitalization per mile of the entire Union Pacific line from Omaha to Ogden. The financial situation of the Kansas Pacific Railway during its independent history may be properly described as desperate. Recklessly overcapitalized, the road made but a feeble effort to meet its fixed charges. It was "poorly built and poorly managed," says one authority.¹ Its books and records apparently were in a state of confusion. In 1887 the expert accountant of the Pacific Railway Commission pictured its situation in forceful language:

Either by accident or design, or in consequence of the continual misfortunes of the company, the books unconsciously reflect the chaotic character of the management, and they never appear to have been systematically written up, so that an accurate and faithful statement of the actual condition of

¹ Stuart Daggett, *Railroad Reorganization*, Boston and New York, 1908, p. 225.

the corporation year by year could be ascertained therefrom. . . . During the fifteen years of the existence of the line its earning power was smothered by heavy and constantly increasing interest and other charges, and if the figures which will presently be presented are duly considered, it will be found that neither the Western nor the Eastern management deserves any credit as a careful conservator of the company's interests.²

While it is not necessary to enter upon a full narrative of this road's early history, a concise outline of its financial affairs is required in order to understand its later relations with the Union Pacific. In 1873 the Kansas Pacific defaulted on the annual interest on its first mortgage, and subsequently, in 1875, the company resorted to the makeshift of funding its overdue interest.³ The road had already in 1874 gone into a receivership, Carlos Greeley and Henry Villard having been appointed receivers. As a consequence of its practically bankrupt condition, its securities had reached a very low ebb. Its stock, which had only a speculative value, was quoted on the stock exchange at figures ranging from about 9 to 12 cents on the dollar.

From 1867 to 1879, inclusive, the net earnings of the Kansas Pacific equaled its fixed charges in only two years, 1868 and 1874. In the ten years of the decade from 1870 to 1880 its nominal fixed charges increased from \$1,005,935.51 to \$1,775,067.33, and in one of these years, 1876, fixed charges amounted to nearly \$2,000,000. Net earnings during the same period averaged less than \$1,000,000 a year. In 1870 there was a deficit of \$790,689.21, resulting from the excess of operating expenses over gross earnings. With this one exception every year showed a surplus remaining after the payment of operating expenses, but with very sharp fluctuations. The operations of the company during the thirteen years of its inde-

² Pac. Ry. Com. Test., p. 4972, reports of accountants.

³ *Ibid.*, p. 4976, reports of accountants; p. 135, testimony of Artemas Holmes.

pendent existence from 1867 to 1879, inclusive, may be thus summarized:⁴

Interest on the funded debt from 1867 to 1879.....	\$15,745,287.43
Net earnings during the same years.....	9,220,218.10
Deficit	\$ 6,525,069.33
Interest on U. S. subsidy bonds unpaid.....	4,805,703.09
Total deficit for thirteen years.....	\$11,330,772.42

Gould's Proposed Pool of Kansas Pacific Securities

Such, then, was the situation of the Kansas Pacific Railway at the close of the year 1879. In 1878, Gould commenced making large purchases of the depreciated Kansas Pacific bonds and stock. By 1879, he had acquired \$4,030,000 of stock out of a total of \$10,000,000,⁵ and, as has already been mentioned, had secured control of the management of the road. Associated with Gould in the Kansas Pacific management was Russell Sage. A number of Union Pacific directors—Sidney Dillon, Elisha Atkins, F. L. Ames,⁶ and several others—acquired small amounts of Kansas Pacific stock about the same time. As Gould bought Kansas Pacific he parted with his Union Pacific holdings, so that at the close of the decade his interest in the Union Pacific was very much less than his interest in the Kansas Pacific.

In 1878, after Gould had already acquired a large, but not

⁴ Pac. Ry. Com. Test., p. 4975, reports of accountants. The figures for the 13 years are as follows:

Year	Net Earnings	Fixed Charges, Not Including Interest Due U. S.
1867	\$ 190,571.56	\$ 467,642.97
1868	495,230.61	364,371.03
1869	437,163.70	497,246.77
1870	—790,689.21 (deficit)	1,005,935.51
1871	264,033.87	1,055,358.70
1872	1,041,904.30	1,190,142.30
1873	923,584.26	1,201,319.45
1874	1,344,867.36	1,338,939.61
1875	1,153,658.07	1,515,097.99
1876	457,553.69	1,924,214.61
1877	1,327,407.79	1,635,731.25
1878	909,456.75	1,774,219.91
1879	1,465,475.35	1,775,067.33

⁵ Pac. Ry. Co. Test., p. 463, testimony of Jay Gould.

⁶ A son of Oliver Ames and a nephew of Oakes Ames.

a controlling interest in the Kansas Pacific, a scheme was devised by Gould and several other large security-holders for the reorganization of the company. It was proposed that the various classes of securities subordinate to the first mortgage, including the capital stock, be pooled and converted into a new stock issue at a certain schedule of reduced commutation rates, according to the market value of each class of security.⁷ The proposition in substance was to substitute a new stock issue of \$4,855,300 for the total outstanding issue of stock and bonds subordinate to the first mortgage, amounting to \$17,330,350. The plan fell through because of the refusal of many of the security-holders to agree to it.⁸ Since such outstanding securities, stock and bonds, would be surrendered to the pool, and new stock in the approximate ratio of 48 to 173 would be given in exchange for the securities surrendered, and since the securities of those who refused to go into the pool remained undisturbed, these latter securities would become relatively more valuable, and therefore those who refused to agree to the plan would secure an unfair advantage. Undoubtedly, too, a plan involving the surrender of securities at a ratio of 173 to 48 was not looked upon with favor by security-holders. The reduction of the securities in the approximate ratio of 173 to 48 involved a reduction in the face value of the securities from 100 per cent to about 27.7 per cent, and this reduction was no doubt regarded by many as extraordinary and as unjust and unfair.

⁷ Pac. Ry. Com. Test., p. 165, copy of plan. The plan was to exchange outstanding securities as follows:

	Par Value of Existing Securities	Rate of Exchange	To Receive in New Stock
Stock	\$ 9,600,000	12½%	\$1,200,000
Floating debt	1,200,000	par	1,200,000
Unsubordinated income bonds.....	227,000	50%	113,500
Subordinated income bonds.....	4,048,350	30%	1,214,350
Second land grant bonds.....	1,055,000	50%	527,500
Arkansas Valley Railway bonds.....	570,000	50%	285,000
Leavenworth branch bonds.....	630,000	50%	315,000
	<u>\$17,330,350</u>		<u>\$4,855,350</u>

⁸ Pac. Ry. Com. Test., p. 455, testimony of Gould.

The Kansas Pacific Consolidated Mortgage

Early in 1879 Gould bought out the interest of certain large stockholders in the Kansas Pacific and thus acquired complete control of the road. It was at this time that the change in the Kansas Pacific board of directors was made which has already been referred to, whereby the men in control of the Union Pacific entered the management of the Kansas Pacific. The former plan for reducing the volume of Kansas Pacific securities was abandoned, and Gould and his associates developed a plan for converting the existing securities subordinate to the first mortgage, but not including the stock, into a new issue of consolidated mortgage bonds. Gould, in explaining this plan later, advanced the specious reason in support of it that its purpose was to fund the existing heterogeneous mass of securities into one uniform security, so as to make a saving in both the annual interest charges and in the principal of the debt.⁹ The plan was carried out. The amount of this consolidated mortgage was \$24,000,000. Of this amount, \$18,000,000 of new bonds were authorized to be issued immediately. This new issue of bonds was primarily secured by a mortgage upon the existing property and lands of the Kansas Pacific Railway, subordinate, however, to the existing first mortgages,¹⁰ the government's second mortgage upon the first 393 15/16 miles west from Kansas City, and to the lien of such bonds of existing issues as were not exchanged for the new bonds. The securities surrendered and certain other securities in the Kansas Pacific treasury¹¹ were deposited in trust as additional col-

⁹ Pac. Ry. Com. Test., p. 456, testimony of Jay Gould.

¹⁰ The first 140 miles west from Kansas City were covered by the "Eastern Division" first mortgage; the next 254 miles to the 394th mile post were covered by the "Middle Division" first mortgage; and the remainder of the line to Denver was covered by the "Denver Extension" mortgage.

¹¹ These securities were as follows:

Denver Pacific stock.....	\$2,998,600
Junction City and Fort Kearney Railway bonds.....	820,000
Junction City and Fort Kearney Railway stock.....	720,000
Arkansas Valley Railway stock.....	1,068,200
National Land Company stock.....	93,800
Kansas Pacific second land grant mortgage bonds.....	395,000

For text of the consolidated mortgage see Sen. Docs. No. 10, Pt. 3, 55th Cong., 1st sess. (serial No. 3559), p. 22.

lateral to secure the payment of these consolidated mortgage bonds. Jay Gould and Russell Sage were named as the consolidated mortgage trustees.

The stock was not included in this plan; but the other subordinate securities were exchangeable for this new security at fixed rates of commutation, according to the class of security surrendered.¹² At the time when the consolidated mortgage was made, the funded debt of the road, not including the government subsidy, was \$27,727,350. This sum included three series of divisional first mortgage bonds, each series covering a portion of the line, a series of unsubordinated income bonds, a series of subordinated income bonds, two series of land grant bonds, one subordinate to the other, and the bonds of three branch roads which were guaranteed by the Kansas Pacific. In addition, there were \$1,500,000 of 10 per cent "funding mortgage bonds," and \$2,500,000 of 6 per cent coupon certificates.¹³ These two securities last named, aggregating \$4,000,000, represented overdue interest which had been funded. Interest charges upon this remarkable collection of bond issues amounted, according to Gould's figures, to \$1,892,134.50, while the annual interest charges on the entire \$24,000,000 consolidated mortgages would be \$1,440,000.¹⁴ Gould declared that a saving therefore of \$3,727,350 in the principal of the debt, and \$452,134.50 in interest had been effected.¹⁵

Gould's figures respecting the saving which was made by the consolidated mortgage were fairly accurate; his statement, however, conveys the impression that the entire Kansas Pacific

¹² First land grant mortgage bonds exchanged at par for new consolidated mortgage bonds and received par for overdue interest warrants. Overdue interest warrants on the first mortgage bonds likewise exchanged at par. The funding mortgage bonds exchanged at par but received nothing for overdue interest warrants. The other securities exchanged at the same percentages which had been fixed under the former proposed pooling plan for exchanging old securities for new stock. Certain details of the consolidation mortgage arrangement are not clear.

¹³ The coupon certificates were known in financial circles as "baby bonds."

¹⁴ Gould's estimate of the annual interest charges of the Kansas Pacific differs somewhat from the results arrived at by the accountants of the Pacific Railway Commission.

¹⁵ Pac. Ry. Com. Test., p. 496, testimony of Jay Gould.

funded debt, including the first mortgage bonds, was converted into consolidated mortgage bonds. As a matter of fact, the first mortgage bonds and the first land grant bonds, although entitled to exchange for consolidated mortgage bonds at par, remained undisturbed.¹⁶ Only the subordinate securities were actually exchanged for new bonds. Of the total debt of the road, aggregating \$27,737,350,¹⁷ \$15,045,350 consisted of bonds other than the three series of divisional first mortgage bonds. Of this amount of securities, about \$11,500,000 had by March, 1880, been converted into consolidated mortgage bonds. Of the authorized issue of \$18,000,000 of new bonds, there had been issued in exchange for old securities surrendered and were outstanding in March, 1880, \$8,450,000 of consolidated mortgage bonds.¹⁸ The funded debt of the road in March, 1880, not including the government subsidy, was reported as follows:¹⁹

First mortgage bonds aggregating*.....	\$12,682,000
Consolidated mortgage bonds outstanding.....	8,450,000
Income bonds outstanding.....	1,124,150
Leavenworth branch bonds outstanding.....	492,000
First land grant bonds.....	1,460,000
Second land grant bonds outstanding.....	350,000
Total funded debt outstanding.....	<u>\$24,558,150</u>

* These first mortgages were as follows: The Eastern Division mortgage was for \$2,240,000; the Middle Division mortgage was for \$4,063,000; the Denver Extension mortgage was for \$6,379,000.

It appears, therefore, that the total funded debt of the Kansas Pacific was reduced from \$27,727,350 to \$24,558,150, and that the amount of the reduction was \$3,169,200. Interest charges amounting to about \$1,500,000 were substituted for interest charges of something over \$1,750,000.

¹⁶ Under the terms of the consolidated mortgage the first mortgage bonds were also entitled to exchange for new bonds at par; this provision, however, remained a dead letter. The first mortgage bonds were a better security than the consolidated mortgage bonds, and no first mortgage bondholders exercised their right of exchanging their bonds for consolidated mortgage bonds.

¹⁷ Not including the government subsidy or the floating debt.

¹⁸ Commercial and Financial Chronicle, Investor's Supplement for March, 1880, p. 54.

¹⁹ *Ibid.*, p. 54.

Some reduction was therefore effected in the Kansas Pacific's fixed charges. The amount of new bonds issued in exchange for old securities was, however, considerably in excess of the amount which it would have been necessary to issue had the agreed rates of commutation been observed in every case. Testimony taken by the Pacific Railway Commission, in 1887, is very confusing on this point, and it is impossible to present exact figures; but it is clear that the exchange ratios were disregarded in a number of instances.²⁰ Had these ratios been observed in each instance, the amount of consolidated mortgage bonds issued at this time to retire the old securities would, at a liberal estimate, have amounted to less than \$7,000,000, instead of nearly \$8,500,000. This discrepancy cannot be accounted for with any certainty. It seems that for some unexplained reason \$3,386,269 of consolidated mortgage bonds were issued to Gould and certain of his associates in exchange for their holdings of old securities at a very much higher rate of exchange for the old bonds than had been provided in the consolidated mortgage plan.²¹ The details of this transaction are hazy and were never explained satisfactorily. The company apparently received no benefit for the difference between the amount of new bonds actually issued and the amount which should have been issued had the old securities been commuted at the agreed rates of exchange.

Before the new consolidated mortgage was executed, the Kansas Pacific was bonded at the very high figure of \$50,565.15 per mile. The capital stock per mile amounted to \$14,710.25 additional, so that the total capitalization per mile was \$65,275.40. Notwithstanding this high capitalization, the physical condition of the road was poor.²² One of its receivers, Henry Villard, subsequently said that the road was

²⁰ Pac. Ry. Com. Test., p. 459, testimony of Jay Gould; p. 974, testimony of C. F. Adams.

²¹ *Ibid.*, pp. 532-4, testimony of Jay Gould; p. 778, testimony of Elisha Atkins.

²² *Ibid.*, p. 210, testimony of Sidney Dillon.

in wretched condition and was an "utterly forlorn railroad property."²³

The Denver Pacific

The Kansas Pacific's subsidiary, the Denver Pacific, was in a like condition of chronic insolvency. Its capital stock, which was divided into 40,000 shares of \$100 each, had no value whatever except for purposes of control. After the consolidated mortgage was executed, 29,986 shares of this Denver Pacific stock, which were owned by the Kansas Pacific and which had formerly been pledged as part security for the Kansas Pacific's issue of 10 per cent funding mortgage bonds, were now deposited with Gould and Sage, trustees, as part collateral for the consolidated mortgage bonds. In 1879, 10,000 shares of Denver Pacific stock, par value \$1,000,000 which had been owned by Arapahoe County, Colorado, were purchased by the Kansas Pacific at 10 cents on the dollar. It does not appear who held the remaining 14 shares.

In 1887, the accountant of the Pacific Railway Commission reported that during the ten years from 1870 to 1879, inclusive, this Denver Pacific Company's net earnings aggregated \$1,412,664.17, while its interest obligations for the first eight years of the decade aggregated \$1,483,903.46.²⁴ For some reason which is not explained, the same report gives no figures for interest charges for 1878 and 1879. In 1878 this road's net earnings declined from \$131,116.15, the figure for the previous year, to \$49,693.36; and the following year they sank still lower. In only three years, 1873, 1874, and 1875, did net earnings come up to the interest charges.

²³ *Ibid.*, p. 433, testimony of Henry Villard.

²⁴ *Ibid.*, p. 4987, reports of accountants. The figures for 10 years are as follows:

Year	Net Earnings	Interest Payments	Year	Net Earnings	Interest Payments
1870.....	\$107,219.81	\$138,535.25	1875.....	\$234,983.69	\$196,680.96
1871.....	91,129.47	197,623.24	1876.....	105,166.33	188,353.96
1872.....	197,378.47	197,432.52	1877.....	131,116.15	175,644.65
1873.....	215,812.93	202,297.66	1878.....	49,193.36	.....
1874.....	242,846.08	187,335.22	1879.....	31,817.88	.....

Rejection of Gould's Proposal of Consolidation

The acts of 1862 and 1864 authorized any two or more of the Pacific railroads to consolidate. In the late fall of 1879, Gould proposed to the leading men interested in the Union Pacific that the three roads, the Union Pacific, the Kansas Pacific, and the Denver Pacific, be consolidated. He suggested that a new corporation be formed whose capital stock should be equal to the sum of the capital stock of the three constituent corporations, the new stock to be issued, dollar for dollar, in exchange for the old stock of each of the three constituent companies.

Gould no longer held a controlling interest in the Union Pacific. As has already been stated, some of the Union Pacific directors had small interests in the Kansas Pacific, while others were not connected with the latter company. The one-sided proposition made by Gould did not commend itself to the majority of the Union Pacific board. Gould's terms were so manifestly unfair that his suggestion was rejected.²⁵ For the Kansas Pacific, a consolidation with a dividend-paying property was highly desirable. For the Union Pacific, such a consolidation meant a further increase in the already large volume of water in its capitalization. If this plan were carried out, the Union Pacific would be compelled to assume the heavy interest obligations of the two other roads, and the stock of the Union Pacific would be increased by \$14,000,000 of paper capital which represented no value whatever.

Consolidation upon reasonable terms was doubtless extremely desirable for the Union Pacific, the Kansas Pacific, and the Denver Pacific. Aside from the incidental benefits which might result through decreased operating expenses, the geographical situation of each road was such that consolidation was likely to prove equally advantageous to the three companies. For the Kansas Pacific and Denver Pacific roads, con-

²⁵ Pac. Ry. Com. Test., pp. 703-4, testimony of F. Gordon Dexter.

solidation meant an outlet to the west under favorable conditions. For the Union Pacific, consolidation meant an end to the cut-throat competition which had at times forced rates to such a low point that the Colorado business could not well be carried at a profit. To be sure, Gould's interest in both the Union Pacific and the Kansas Pacific had for a time brought peace; but the agreement pooling the traffic between the Union Pacific and the Kansas Pacific already referred to²⁶ might cease at any time, especially if Gould should end his connection with one road or the other, or in case it should no longer be to his interest to continue the existing harmonious relations. Before the Kansas Pacific could be classed as a good railroad property, it would be necessary to reorganize it; but after a thorough reorganization which would reduce the volume of its inflated obligations to a point which would approximate the road's value and be within its earning capacity, a consolidation of the Union Pacific and the Kansas Pacific upon a fair relative valuation of the constituent companies would probably have been highly beneficial to both properties.

Gould was not interested in such a consolidation. If the companies were to be consolidated upon his terms, he would be able to exchange his Kansas Pacific for dividend-paying Union Pacific stock, and his large holdings of Kansas Pacific bonds would become worth par, since behind them would be the guaranty of the Union Pacific. Gould would consent to consolidation upon no other terms than those he proposed. Hopelessly insolvent as the Kansas Pacific was, it had a destructive power which finally forced the Union Pacific to yield. Prior to 1878, the Kansas Pacific had been an annoying but not a dangerous competitor, for its desperate financial condition was a safe guaranty against the one thing the Union Pacific feared—the extension of the Kansas Pacific to Ogden. Now, however, Gould and Sage controlled the Kansas Pacific, and they were well able to command the credit necessary to

²⁶ See *supra*, p. 122.

finance the construction of a separate line to Ogden, if their interests should so direct. It was Gould's threat to carry out this project which eventually brought the Union Pacific to terms.

Gould's Threat of Competing Line

Upon the Union Pacific's refusal to agree to his plan of consolidation, Gould at once announced his purpose to extend the Kansas Pacific through Colorado by way of the Loveland Pass to Ogden.²⁷ If he did this he would have control of a through line from the Missouri River to the eastern terminus of the Central Pacific at Ogden. From Colorado to the Missouri River the Union Pacific had already been forced to meet the competition of a road which did not meet all of its fixed charges and could therefore reduce its rates to a very low figure. If the Kansas Pacific had its own outlet to Ogden and the Pacific Coast, it would become a much more dangerous competitor than it had theretofore been. The construction of new railroads west of the Missouri River was already beginning to affect the Union Pacific, and competition was becoming constantly more severe. The Burlington, the Northwestern, and other companies were building westward, and the Denver and Rio Grande line to Ogden was nearing completion in the fall of 1879. The beginning of the end of the Union Pacific monopoly had already commenced, and the Union Pacific people were naturally alarmed at this possible additional competition of the Kansas Pacific between Denver and Ogden.

Gould's plan was threatened by the expansion policy of the Missouri Pacific. This road connected Kansas City with the east. To forestall the competition which would result from its westward extension, Gould bought a controlling interest in it, in November, 1879.²⁸ The possession of this road gave

²⁷ Pac. Ry. Com. Test., p. 505, testimony of Jay Gould.

²⁸ *Ibid.*, p. 509, testimony of Gould.

Gould control of a line reaching from St. Louis to Cheyenne.

Before the end of the year 1879, Gould strengthened his grip on the western railroad situation by purchasing, in a surprisingly short time and apparently without negotiation, two other short agricultural lines in Kansas. One of these two roads, the Kansas Central, was a narrow-gauge line of little value which ran west from Leavenworth, Kansas, for about 150 miles. The other was the Central Branch Union Pacific Railroad, which with its branches included a system of about 250 miles. This road and its feeders tapped the agricultural region west of Atchison, Kansas. Gould had now an additional weapon; for by extending either the Kansas Central or the Central Branch he could cut into the Union Pacific's local agricultural business. Gould's eagerness to acquire the Central Branch road may be gauged by the price which he paid for 7,616 shares, par value \$761,600, of that company's stock. The Central Branch road, while apparently a valuable property intrinsically, was, like the other subsidized Pacific railroads, burdened with a capitalization out of all proportion to its cost. The company had met with repeated financial reverses and had defaulted on its interest. Within a year previous to this time its stock had sold at 10 cents on the dollar. Nevertheless, Gould bought his stock at figures ranging from 175 to 250, the average price which he paid for the whole amount being 239 cents on the dollar.²⁹

Gould had now one weapon with which to attack the Union Pacific's local business and another with which to ruin its through business. When Gould was later asked what effect the proposed extension of the Kansas Pacific would have had on the Union Pacific, he answered, "It would have destroyed it."³⁰

The Union Pacific people were now thoroughly alarmed and eager to choose what appeared to be the lesser of two evils,

²⁹ Pac. Ry. Com. Test., p. 525, testimony of Gould. The history of the Central Branch road is very interesting, but is beyond the scope of this work.

³⁰ *Ibid.*, p. 509, testimony of Gould.

namely consolidation on Gould's terms.³¹ It seems that now it was they, not Gould, who urged consolidation. Apparently, it had become a matter of indifference to Gould; he was in a position to dictate, and if the Union Pacific people were not prepared to agree to his terms they would suffer the consequences. According to one Union Pacific director, consolidation was now a matter of life and death to the Union Pacific.³² The following extract from the testimony of Oliver Ames before the United States Pacific Railway Commission of 1887 indicates how completely Gould had the whole situation in his power:

THE WITNESS. If you had seen those Union Pacific Directors as I did, just about the time the consolidation took place, you would have pitied them.

COMMISSIONER LITTLER. It is pretty clear that Mr. Gould had them cornered.

THE WITNESS. He had. I was an outsider, and could see it all and enjoy it all.³³

Acceptance of Gould's Terms of Consolidation

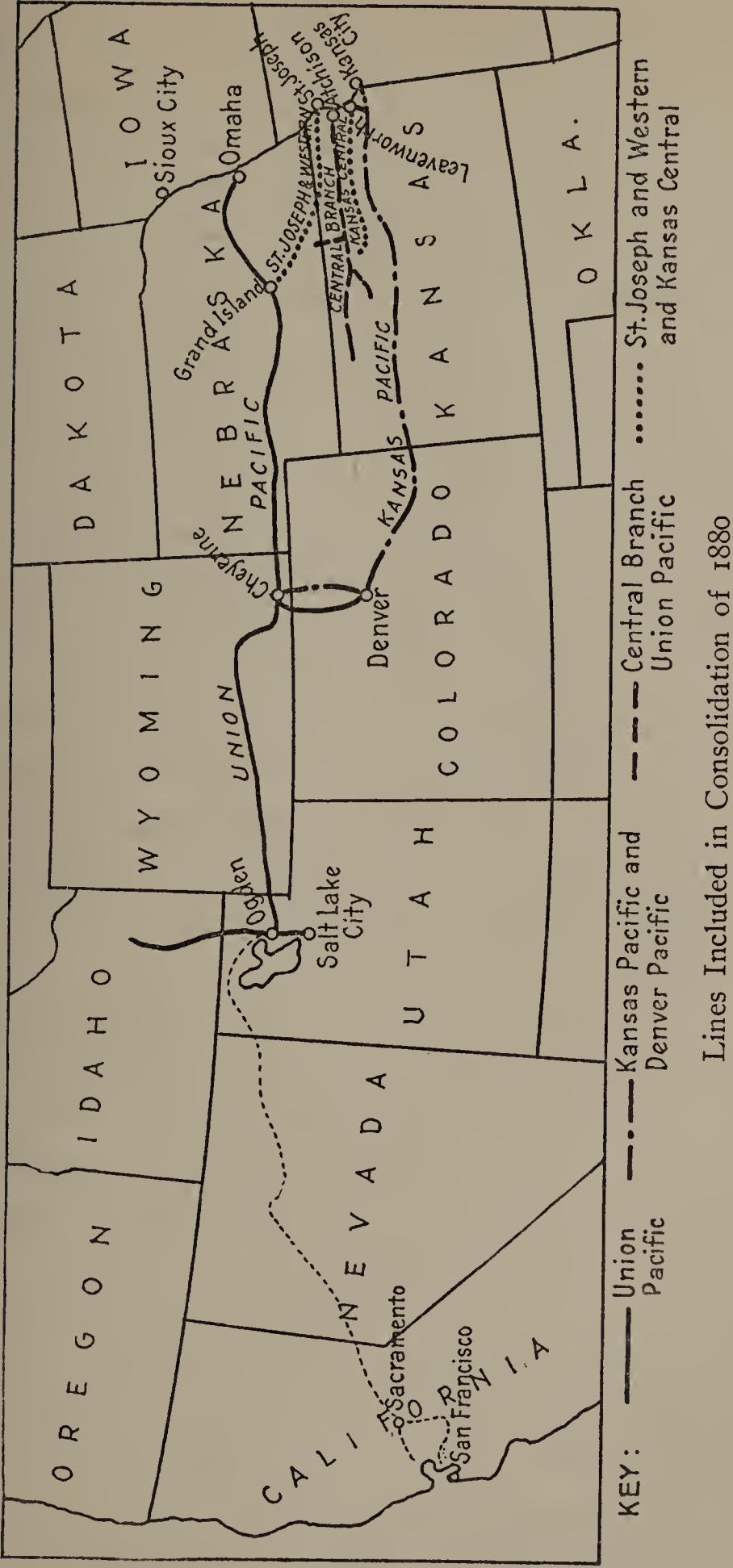
At a meeting at Gould's house in New York on January 14, 1880, the alarmed Union Pacific directors concluded an informal agreement with Gould and Sage, which was later ratified at board meetings of the Union Pacific and Kansas Pacific companies on January 24, 1880.³⁴ Under the terms of this agreement, the three companies, the Union Pacific, the Kansas Pacific, and the Denver Pacific, were to be consolidated into a new company. The capital stock of the new company was fixed at \$50,762,300, the sum of all the stock of the three constituent companies which had been issued. This new stock was to be issued, dollar for dollar, in exchange for the old stock of each company. The existing bonded indebtedness of each road remained undisturbed. The name of the new

³¹ Pac. Ry. Com. Test., p. 705, testimony of F. Gordon Dexter.

³² *Ibid.*, p. 689, testimony of F. L. Ames.

³³ *Ibid.*, p. 818, testimony of Oliver Ames. (This witness should not be confused with the Oliver Ames, who was one of the builders of the road.)

³⁴ *Ibid.*, p. 307, transcripts of the directors' minutes.



corporation was changed to the Union Pacific Railway Company.

The Missouri Pacific was left out of the consolidation; but as a part of his Union Pacific-Kansas Pacific consolidation scheme Gould insisted that his holdings in several small railroad companies in Kansas and his holdings in a corporation known as the St. Joseph Bridge Company, none of which formed a part of either the Union Pacific or Kansas Pacific system, be included in the consolidation. Both the Kansas Central and the Central Branch were therefore included. Gould's purchases of bonds and stocks of the Kansas Central seem to have cost him \$431,820.25. These securities he exchanged for 4,790 shares, par value \$479,000, of stock in the consolidated company.³⁵ For his 7,616 shares, par value \$761,600, of Central Branch stock, which had cost him \$1,826,500, Gould received \$913,500 in Union Pacific first mortgage bonds and \$913,500 in Kansas Pacific consolidated mortgage bonds.³⁶ Thus Gould recouped out of the Union Pacific itself the expense he had incurred in purchasing these two roads which he had bought in order to bring the Union Pacific to terms.

The Central Branch road had no junction point in common with the Union Pacific. According to Gould, the Central Branch was included in the consolidation in order to prevent its falling into the hands of the Missouri Pacific; for by becoming the property of the Missouri Pacific it could have extended and thus become a competitor of the Union Pacific.³⁷ The road, however, was at once leased to the Missouri Pacific, ostensibly for the purpose of enabling the latter company to enjoy the benefit of the Central Branch as a feeder. Gould declared that this was done to play fair with the Missouri

³⁵ Pac. Ry. Com. Test., p. 523, testimony of Gould.

³⁶ *Ibid.*, p. 527, testimony of Gould. It is not wholly clear from what source the securities received by Gould were made available. Probably treasury stock, and bonds held by the Union Pacific and Kansas Pacific, were used to buy these two roads, namely, the Central Branch Union Pacific, and the Kansas Central.

³⁷ *Ibid.*, p. 527, testimony of Gould.

Pacific.³⁸ Under the arrangement the lessee company paid the cost of operating the road and received the benefit of its interchange traffic, while it turned over the net receipts to the Union Pacific.³⁹

The consolidation therefore not only enabled Gould to exchange his Kansas Pacific stock for dividend-paying Union Pacific stock; the Union Pacific even indemnified him for his expense and trouble in securing the Kansas Central and the Central Branch, both of which he had purchased at excessive prices for the specific purpose of bringing the Union Pacific to terms. The Kansas Central was at that time of little value.⁴⁰ Although the Central Branch was a better property, its possession could not afford the Union Pacific any advantage by way of interchanged business to offset the heavy price paid for it, or to justify the Union Pacific in assuming its fixed charges. The road had been forced on the Union Pacific. When Gould's purpose was accomplished and the Central Branch became a part of the Union Pacific system, the Union Pacific, rather than face probable heavy losses by operating the road, leased it to the Missouri Pacific. This is probably the reason why the road was leased to the Missouri Pacific, not that stated by Gould.

In the annual report of the Union Pacific it is stated that the consolidation was "decided upon after mature consideration as being for the best interests of the Union Pacific and Kansas Pacific roads, not only promising a diminished ratio of operating expenses, but disposing of many questions of a vexatious and disturbing nature between the companies."⁴¹ Yet, in 1887, Sidney Dillon, who was president of both the Union Pacific and the Kansas Pacific when the two roads were united, testified as follows before the Pacific Railway Commission in reference to the consolidation:

³⁸ *Ibid.*

³⁹ *Ibid.*, p. 56, testimony of C. F. Adams.

⁴⁰ *Ibid.*, p. 76, testimony of Adams.

⁴¹ Annual Report for 1879, p. 15.

[The depreciated stock and bonds of the Kansas Pacific became valuable] the same as a man's note which goes to protest, and a good man puts his name on the back of it, he makes it worth par, when today it was not worth the paper on which it was written; and that is the same as that stock was at that time.

THE CHAIRMAN. The man whose name is on the back of the note has to pay for it.

THE WITNESS. The man whose name was on the back did pay for this.

THE CHAIRMAN. That was the way with the Union Pacific?

THE WITNESS. Yes, sir.⁴²

Gould's Sale of St. Joseph and Western Railroad

During 1879 Gould had acquired the securities of the St. Joseph and Western Railroad, a local line in Kansas. This company appears to have had a checkered history. It was not a paying property at that time, and its securities had little value. Gould was also the owner of some bonds of the St. Joseph Bridge Company, a corporation which owned the bridge over the Missouri River that gave the St. Joseph and Western an entrance into St. Joseph, Missouri. When the Union Pacific and the Kansas Pacific were consolidated, Gould exchanged the various classes of securities which he owned in these two companies for stock in the Union Pacific Railway Company. The device by which the Union Pacific was provided with stock with which to pay for these securities is described in the Report of the Pacific Railway Commission as "the most ingenious feature of the whole scheme."⁴³ The following clause in the informal agreement which was drawn up at the meeting at Gould's house ten days before the constituent companies formally ratified the articles of consolidation, explains what stock was to be used for this purpose:

The Denver Pacific capital, now an asset of the Kansas Pacific, to be used after conversion into Union Pacific Rail-

⁴² Pac. Ry. Com. Test., p. 209, testimony of Sidney Dillon.

⁴³ Pac. Ry. Com. Report, p. 63.

way stock, to pay for shares and bonds of Saint Joseph and Western Railroad Company and St. Joseph Bridge Company, as hereafter stated, and for other purposes.

It will be remembered that of the \$4,000,000 of capital stock of the Denver Pacific, the Kansas Pacific had become the owner of 10,000 shares, par value \$1,000,000, which had formerly been owned by Arapahoe County, Colorado. Of the remaining 30,000 shares of stock of this company, 29,986 shares, par value \$2,998,600, which the Kansas Pacific owned had been deposited with Gould and Sage, the consolidated mortgage trustees. It was necessary to release these 29,986 shares from the trust in order to carry out the plan of the proposed purchase of the securities of the St. Joseph and Western and of the St. Joseph Bridge Company. The manner in which this release was obtained in anticipation of the consolidation of the Union Pacific and the Kansas Pacific is thus summed up in the caustic language of the Pacific Railway Commission:

It would certainly have puzzled a convention of lawyers to have devised a method by which this stock, so held on the 14th of January, 1880, could have been applied within ten days thereafter, to the purposes intended by the agreement above quoted. And yet this extraordinary feat was performed. A suit was manufactured, in which the Kansas Pacific Railway Company was made the plaintiff, and Jay Gould and Russell Sage the defendants, and the entire machinery of complaint, answer, trial, decree and execution was carried to a finish by the 23rd day of the same month. The details of this singular and expeditious litigation are familiar to everyone conversant with this consolidation, and are fully detailed in the testimony.⁴⁴

During the course of the testimony taken in this extraordinary suit which was brought to release this Denver Pacific stock, Sidney Dillon, the president of both the Union Pacific and of the Kansas Pacific, was asked:

State the outside sum which it (these 29,986 shares of Denver Pacific stock) would be worth to the Kansas Pacific

⁴⁴ Pac. Ry. Com. Report, p. 63.

Railway Company for that control (referring to the control of the link from Denver to Cheyenne) or freed from the present mortgage.

Dillon answered:

This stock, tied up in trust, as I said before, I do not consider worth anything; to carry out certain things I think it might be worth to the Kansas Pacific Company, a small sum, say \$200,000 or \$300,000; something in that neighborhood.⁴⁵

On January 23, 1880, the court decreed that these 29,986 shares be released from the consolidated mortgage trust in consideration of the payment of \$500,000 by the Kansas Pacific to the trustees.⁴⁶ This Denver Pacific stock having been released, everything was ready for the consolidation so far as Gould's scheme was concerned. The consolidation of the Kansas Pacific with the Union Pacific was ratified on the following day, and the released 29,986 shares of Denver Pacific stock were exchanged for 29,986 shares, par value \$2,998,600, of stock in the Union Pacific Railway Company. The other 10,000 shares of Denver Pacific stock which were already free were likewise exchanged, dollar for dollar, for new Union Pacific shares. At this time Union Pacific stock was selling in the neighborhood of 93; so that these 29,986 shares, par value \$2,998,600, for which only \$500,000 had been paid, became suddenly worth 93 cents on the dollar, or \$2,788,047.

This Denver Pacific stock which had been thus converted into new Union Pacific stock was now available for the purpose of completing Gould's plan to sell his St. Joseph and Western and St. Joseph Bridge Company securities to the Union Pacific Railway. It seems that 34,641 shares, par value \$3,464,100, of new Union Pacific stock were delivered to him in exchange for various stocks and bonds of the St. Joseph

⁴⁵ Pac. Ry. Com. Test., p. 208. (Contains an extract from Dillon's testimony at this trial.)

⁴⁶ *Ibid.*, p. 152.

and Western and the St. Joseph Bridge Company.⁴⁷ The St. Joseph and Western was the successor of several other companies, and its securities which Gould turned over to the Union Pacific included bonds and receivers' certificates of these predecessor companies. The testimony regarding the purchase of some of these securities is so confusing and uncertain that an exact statement of the whole transaction is impossible. Its nature may, however, be fairly well understood from the testimony of Gould relating to the circumstances of the purchase of some bonds of one of these predecessor companies which had been known as the St. Joseph and Denver. Between January 14, 1879, and January 24, 1880, Gould purchased, at 40 cents on the dollar, \$956,779.76, par value, of bonds and scrip of the St. Joseph and Denver.⁴⁸ Thus

The par value of these bonds and scrip was.....	\$956,779.76
They cost Gould.....	356,404.78
For which he received Union Pacific Railway stock, par value..	956,800.00

Gould's transaction with reference to the bonds of the St. Joseph Bridge Company was as follows:⁴⁹

St. Joseph Bridge Company bonds, par value.....	\$634,000.00
They cost Gould.....	474,440.00
For which he received Union Pacific Railway stock, par value...	634,000.00

Thus it is apparent that by these sharp manipulations in regard to the securities of the St. Joseph and Western Railroad and its predecessor companies, and the St. Joseph Bridge Company, Gould made large profits for himself at the expense of the Union Pacific Railway. The amount of his profit cannot be ascertained from the evidence available.

Gould was not the only gainer by these various transactions. Several Union Pacific directors had at Gould's suggestion purchased some of these securities which were thus included in the consolidation. Says the report of the Pacific Railway Commission:

⁴⁷ *Ibid.*, p. 306, testimony of Oliver W. Mink.

⁴⁸ *Ibid.*, p. 468, testimony of Gould.

⁴⁹ *Ibid.*, p. 469, testimony of Gould.

A singular feature of this extraordinary transaction is that a small percentage of all the bonds and stock of these branch lines (referring especially to the St. Joseph and Western and its predecessor companies and to the St. Joseph Bridge Company) had been taken from Mr. Gould by all of the parties to this agreement, at the same prices which he himself had paid. The result was that when he had terrified them into submission to the general terms of consolidation, and the minor subject arose of fixing the terms on which he should dispose of branch lines and connections . . . he had so arranged their personal interests that when the adjustment of these terms became a matter of discussion, all of these trustees and directors had been placed in such a position that a concession of good terms to Mr. Gould himself would automatically result in a large profit to the other directors agreeing to the terms proposed.⁵⁰

Criticism of Terms of Consolidation

The main features of the consolidation of 1880 may be summed up as follows:

1. Ten millions, par value, of Kansas Pacific stock and four millions, par value, of Denver Pacific stock, which together represented a fictitious capitalization of \$14,000,000, were unloaded on the Union Pacific. The capital stock of the Union Pacific, which already amounted to \$36,762,300, all or virtually all of which had been originally issued as a gratuity, was now increased to \$50,762,300.

2. The Kansas Pacific bonded debt, embracing first mortgage bonds, a government subsidy debt, consolidated mortgage bonds, and some unretired bonds of older issues, the entire funded debt including the government subsidy being in excess of \$30,000,000, was unloaded on the Union Pacific.

3. The securities of several small Kansas roads, namely, the Kansas Central, the Central Branch Union Pacific, and the St. Joseph and Western, as well as of the St. Joseph Bridge Company, were unloaded on the Union Pacific at figures out of all proportion to their real value.

⁵⁰ Pac. Ry. Com. Report, p. 62.

Such are the facts as they appear from the voluminous amount of testimony which was later taken in regard to this consolidation. It must not be imagined, however, that the consolidation was an unmixed evil for the Union Pacific. As a matter of fact, the stock of the consolidated Union Pacific Railway Company was soon quoted at higher prices than had been the stock of the old railroad company. Before the end of the year 1880 Union Pacific stock was selling considerably above par. A large volume of business enabled the road to meet its inflated obligations for several years more, while at the same time the company continued to pay dividends at the rate of 6 and 7 per cent per annum. The combined management of the two roads resulted in more economical operation. Moreover, the consolidation put an end to the competition between the Union Pacific and the Kansas Pacific, and higher rates were now for a short time maintained. Doubtless, of the two alternatives, consolidation on Gould's terms, or the carrying out of Gould's threat to extend the Kansas Pacific, consolidation was the less of two evils for the Union Pacific.

Notwithstanding Gould's attempts to explain away the facts, his statements and testimony can hardly be taken to establish even a colorable justification for his course in reference to the Union Pacific. The heavy obligations of the bankrupt Kansas Pacific and Denver Pacific roads were heaped upon the Union Pacific, and their worthless shares of stock were exchanged at an equality for dividend-paying stock of the Union Pacific. Nevertheless an impartial presentation of these various transactions makes it necessary to consider and analyze briefly the case which Gould offered in defense of the consolidation.

Gould declared it to be his judgment that of the Union Pacific and the Kansas Pacific, the latter road was the more valuable property. The character of the soil of the region through which the Kansas Pacific ran was rather better than that of the region in Nebraska along the line of the Union

Pacific. During this period Kansas was rapidly filling up with agricultural settlers. Within the year immediately preceding the consolidation the business of the Kansas Pacific had shown a very large increase; so that its net earnings, which had amounted to \$909,456.75 in 1878, reached the sum of \$1,465,475.35 in 1879, an increase of 61 per cent. As Kansas City, the eastern terminus of the Kansas Pacific, lay 50 miles farther east than Omaha, the eastern terminus of the Union Pacific, the Kansas Pacific passed through 50 miles more of agricultural country than did the Union Pacific. Indications pointed, so Gould declared, to a constant increase in the Kansas Pacific's local traffic; while the competition of the new lines that were then building, the Burlington, the Rio Grande, and the Southern Pacific, would soon put an end to the Union Pacific's long monopoly of the through business. The Kansas Pacific possessed valuable terminal properties in Kansas City and in Denver, which were greatly superior to any terminal properties owned by the Union Pacific. The future, not the past, said Gould, should be the criterion by which the value of a railroad property should be judged. The condition of the Kansas Pacific, which he asserted was an immensely valuable property intrinsically, Gould attributed to bad management. It was less expensive to operate, and as it lay many miles farther south and 2,000 feet lower in elevation⁵¹ than the Union Pacific, it was exposed to less danger of obstruction from snow. The capital stock per mile of the Kansas Pacific was, moreover, less than half that of the Union Pacific, as the following table shows:⁵²

ROAD	CAPITAL STOCK PER MILE
Union Pacific	\$35,382
Kansas Pacific	14,710
Denver Pacific	37,735

⁵¹ This statement is very inaccurate. As a matter of fact, in the same longitude the difference in elevation is very slight, being only a few hundred feet at most.

⁵² For Gould's argument see Pac. Ry. Com. Test., pp. 583 ff.

Gould's estimate of the relative value of the two roads failed to take into account the fact that, although the net earnings of the Kansas Pacific had increased in 1879 to \$1,465,475.35, its interest charges for that year were \$1,775,067.33, according to the report of the accountants of the Pacific Railway Commission. Gould himself testified that the Kansas Pacific's annual interest charges amounted to \$1,892,134.50.⁵³ From 1874 to 1880 there was not a time when the Kansas Pacific was not in default on some of its interest obligations.⁵⁴ According to the testimony of Amos Calef, Gould's secretary, there was not a chance that the Kansas Pacific could ever have paid a dividend on its stock if it had not been consolidated with the Union Pacific.⁵⁵ Gould's statement as to the relative expense of operating the two roads is misleading, although it is true that it cost more per mile to operate the Union Pacific than it cost to operate the Kansas Pacific; for the ratio of operating expenses to gross earnings was much higher in the case of the Kansas Pacific than in the case of the Union Pacific, as the following table shows:⁵⁶

	KANSAS PACIFIC	UNION PACIFIC
Gross earnings per mile.....	\$7,151.57	\$12,455.06
Operating expenses per mile.....	3,976.21	4,967.72
Surplus earnings per mile.....	3,175.36	7,487.34
Taxes per mile.....	193.95	285.06
Net earnings per mile.....	2,981.41	7,202.28
Percentage of operating expenses to gross earnings.....	55½%	38%

In the face of these facts, Russell Sage went so far as to assert that he did not believe that the consolidation played fair with the Kansas Pacific; while Gould insisted that he made no money out of the consolidation.⁵⁷ The basis upon which these extraordinary statements were made was the singular

⁵³ See *supra*, p. 152.

⁵⁴ Pac. Ry. Com. Test., p. 300, testimony of Amos Calef.

⁵⁵ *Ibid.*, p. 299.

⁵⁶ *Ibid.*, p. 972, figures submitted by C. F. Adams.

⁵⁷ *Ibid.*, p. 394, testimony of Russell Sage; p. 558, testimony of Jay Gould.

circumstance that in spite of the insolvent condition of the Kansas Pacific, its stock was in January, 1880, actually higher in the market than the stock of the Union Pacific. Frederick L. Ames attributed this high valuation of Kansas Pacific stock to the fact that it was known that Gould held a great deal of it.⁵⁸ It is, moreover, not unreasonable to assume that the anticipated consolidation of the Kansas Pacific with the Union Pacific raised the value of Kansas Pacific stock. Its high market value all through January, 1880, had no sound basis and consequently could not be permanent. Unless it were reorganized the Kansas Pacific as an independent road could never have paid a dividend. Had consolidation with the Union Pacific not taken place, Kansas Pacific stock would not have been worth 10 cents on the dollar, according to Artemas Holmes, who had been an official of the Kansas Pacific, and who remained as an official of the consolidated company.⁵⁹ It is a matter of common knowledge that the market quotations of stock can be forced up by manipulation. One Wall Street broker testified in 1887:

The way is to bid for things that are not to be found just at the time. You have them already and they are locked up. You bid for them or get somebody else to bid for them, till there are half a dozen bids; nobody offers; the price advances.⁶⁰

In January, 1879, Kansas Pacific had ranged from 9 $\frac{1}{8}$ to 13. It advanced rapidly during the year 1879, until in January, 1880, it was quoted at 107. Union Pacific in January, 1880, was in the neighborhood of 93.⁶¹ It is hardly probable that Gould could have sold his shares of Kansas Pacific for anything like 107. Any attempt on his part to unload his four millions of Kansas Pacific stock upon the public would at once have greatly depressed its market value. This would

⁵⁸ Pac. Ry. Com. Test., p. 675, testimony of F. L. Ames.

⁵⁹ *Ibid.*, p. 179, testimony of Artemas Holmes.

⁶⁰ *Ibid.*, p. 417, testimony of Charles W. Hassler.

⁶¹ Quotations published in the files of the Commercial and Financial Chronicle.

have happened even if Kansas Pacific had been a dividend-paying security. Stock of a corporation which cannot meet all of its fixed charges will not long be quoted at a premium. Gould's assertion that he did not profit by the consolidation will not bear analysis. During 1878 and the early part of 1879 Gould had purchased over \$4,000,000, par value, of Kansas Pacific stock at about 12 cents on the dollar. This stock he exchanged, dollar for dollar, for dividend-paying stock in the Union Pacific Railway. This does not take into account the various branch line securities which he sold to the Union Pacific, nor his transactions in Kansas Pacific bonds.

That such a shrewd financier and stock operator as Gould would have done as he did unless it had been to his advantage is incredible; although one would believe from reading the sworn statements of Gould and Sage as witnesses before the Pacific Railway Commission in 1887, if their remarkable assertions were accepted at their face value, that the idea of making any profit never occurred to them, but that in every transaction they were guided by the highest and most disinterested motives, and that in fact their operations more frequently resulted in loss rather than in gain to themselves.⁶²

The relative earning capacity of each of the three companies can be best appreciated from the following figures:⁶³

	UNION PACIFIC	KANSAS PACIFIC	DENVER PACIFIC
Average net earnings per annum..	\$5,835,713.37	\$1,077,988.45	\$141,266.42
Average net earnings per mile per annum.....	5,616.66	1,601.77	1,322.70
Average interest per mile per annum.....	3,185.39	2,294.71	1,749.89
Average surplus per mile per annum.....	2,431.27	-692.94*	-427.19*
* Deficit.			

During the six years previous to the consolidation of 1880, the Union Pacific Railroad had shown great earning power;

⁶² Pac. Ry. Com. Test., pp. 446-592, testimony of Gould, especially pp. 509, 510, 589; pp. 340-400, testimony of Sage, especially pp. 393-6.

⁶³ *Ibid.*, p. 4989, reports of accountants.

but it had distributed such large dividends that no provision had been made for future hard times, nor for meeting its honest obligations to the government. In 1880, the consolidation increased its capital stock by \$14,000,000 which represented no real value. The consolidated company had a heavy bonded debt, much of which represented water. The days of the Union Pacific monopoly were now drawing to a close. New railroads were building in the west and competition was increasing each year. For over three years in the face of a rising floating debt the Union Pacific continued to pay dividends at the rate of 6 and 7 per cent per annum. Its stock became known as a regular dividend payer and was quoted, on the market, at a premium.

Gould remained for nearly three years on the board of directors, but during this period, while the road was still paying dividends, he unloaded his Union Pacific stock throughout the country. After 1883 his connection with the road ceased for several years.

CHAPTER VIII

AUXILIARY AND BRANCH LINES

Growth of the Union Pacific System

Combination, consolidation, and expansion have from the beginning characterized American railroad history. Especially has this been true of the period since the Civil War and Reconstruction. Although expansion developed gradually, it was nevertheless steady and certain. It was in the late seventies and in the eighties that the foundations were laid for the great transportation lines which are now comprehended within the Union Pacific system. In 1869 the Union Pacific Railroad extended from Omaha to Ogden, a distance of 1,038 miles. It had no branches or feeders. At the present time (1923) the Union Pacific system¹ includes the original line from Omaha to Ogden; the former Kansas Pacific-Denver Pacific line from Kansas City to Cheyenne; a cut-off from Julesburg, Colorado, to Denver; an extensive system of local branch lines which taps the agricultural region of Nebraska, Kansas, and eastern Colorado; a line of about 450 miles from Salt Lake City to the mining district of Montana; and control of two independent outlets to the Pacific Coast. Of these two outlets to the Coast, one is the Oregon Short Line, which with the Oregon-Washington Railroad and Navigation Company, connects the Union Pacific main line with Portland, Seattle, and Spokane. This northern outlet to the Coast is absolutely owned by the Union Pacific. The other outlet is the Los Angeles and Salt Lake Railroad from Salt Lake City to Los Angeles. In this company also the Union Pacific now has the complete ownership.

¹ The word "system" is used to include, in addition to the lines owned by the Union Pacific Railroad Company itself, the lines of companies controlled by the Union Pacific.

This great system, which has played a most important part in the economic history of the west, is an excellent concrete illustration of railroad expansion. Beginning early in the seventies, the company entered upon a policy of constructing and acquiring a system of auxiliary lines. Toward the close of the decade from 1870 to 1880 this expansion development became very pronounced. In some cases, already existing lines were acquired by, or consolidated with, the Union Pacific. Sometimes expansion was brought about by the construction of new lines to serve as feeders to the main line. In some instances expansion resulted from both consolidation and construction, the Union Pacific first acquiring an already existing road and then extending it.

Two factors operated to bring about the growth and development of the Union Pacific system. Many, probably most, of the auxiliary lines were acquired or constructed in order that they might serve as feeders to the main line and secure to the main line the traffic of territory adjacent to it. Some branches and subsidiary corporations, however, came into the system through the manipulation of the directors and managers of the company, especially at the time of the consolidation of 1880, when, as has already been explained, several local branch lines of very uncertain value were unloaded on the Union Pacific.

With certain exceptions, a map of the Union Pacific system as it is today shows substantially the same lines as are shown in a map of the system as it was in 1885.² To be sure, since that date the Union Pacific acquired the main line of what is now the Colorado and Southern line from Denver to Galveston, Texas; and for over eleven years, from 1901 to 1912, the Union Pacific controlled the network of lines owned by the Southern Pacific Company. Neither of these two last

² The Oregon Railroad and Navigation Company, or as it is now known, the Oregon-Washington Railroad and Navigation Company, is one of these exceptions. The extension of the Los Angeles and Salt Lake line from southern Utah to southern California is another exception. The other exceptions are all local branches.

named systems is today a part of the Union Pacific system. Consideration of their relations with the Union Pacific will be postponed until later. In this chapter the discussion is properly limited to the growth and operation of the system during the years between the date of the road's completion and the middle of the decade from 1880 to 1890. Among the most important lines which came within the control of the Union Pacific during this period should be mentioned the Utah and Northern, the Utah Central, the Oregon Short Line and the Kansas Pacific. The Union Pacific-Kansas Pacific consolidation has already been discussed. A brief outline of the history of each of the other three lines which have just been mentioned is necessary before the auxiliary system is considered as a whole.

The Utah and Northern; the Utah Central; the Utah and Southern

Soon after the Union Pacific main line was completed to Ogden, it seems that some Mormon interests became engaged in the construction of a railroad line which ran north from Ogden through the Cache Valley, in northern Utah. This road, the Utah and Northern, was for some years nothing more than a spur through a Mormon settlement. Its promoters appear to have lost money, and apparently lacked either the ability or the capital to develop the road. It terminated at Pocatello, in southern Idaho. About 1873 the Utah and Northern attracted Gould's attention. The road lay in the direction of Montana, where mining development was already showing great promise. Apparently with a view of extending it northward, Gould purchased a controlling interest in this road, paying about 40 cents on the dollar for its bonds and receiving its stock as a bonus.³ In 1875, according to Gould's statement, he turned his bonds and stock of the Utah and Northern over to the Union Pacific at the same price which

³ Pac. Ry. Com. Test., p. 572, testimony of Gould.

they had cost him. Later in the decade from 1870 to 1880 the Union Pacific extended the Utah and Northern road to the Montana mining district, to a point near Butte, Montana. Subsequently, in 1886, the road was completed to Butte.⁴ This road, which is somewhat over 450 miles long, is now a part of the system of the Oregon Short Line Railroad Company.

In the eighties the Union Pacific held a predominating interest in the Utah Central Railway, a long feeder which ran from Ogden southwest, and tapped the rich mines of Utah Territory. This road was, early in the first decade of the present century, extended to California. Its early history was related in 1887 by its vice-president, the Mormon bishop, John Sharp, in the course of his testimony before the Pacific Railway Commission.⁵

It seems that Brigham Young and some of his Mormon associates, a short time after the Pacific Railroad was completed in 1869, determined upon the construction of a line of railroad 37 miles long between Salt Lake City and Ogden. For this purpose they organized a company which was known as the Utah Central Railroad Company. The road was financed by a bond issue of \$1,000,000, par value. The capital stock was fixed at \$1,500,000, on which 16 per cent was actually paid in; the balance was issued as a bonus. The road was opened early in 1870.

Brigham Young, who owned one-third of this company's stock, decided to sell out his interest. He succeeded, in or about 1872, in inducing the Union Pacific to buy from him his 5,000 shares of stock, par value \$500,000, at 50 cents on the dollar. By this purchase the Union Pacific acquired not an absolute but a "proprietary" interest, so-called, in the Utah Central road. The Utah Central was not, like the Utah and Northern, operated as an integral part of the Union Pacific system; the Utah Central was operated independently, but as

⁴ Annual Report for 1886, p. 15.

⁵ Pac. Ry. Com. Test, pp. 2154 ff., testimony of John Sharp.

the Union Pacific Railroad was the principal stockholder it dominated the policy of the management of this road.

South of Salt Lake City is an important mining district. The Utah Central management decided to extend their road southward for about 240 miles to the Horn silver mines, which were at the little village of Frisco, Utah. Work on this southern extension was commenced late in the decade from 1870 to 1880. The line south of Salt Lake City was constructed by a subsidiary corporation known as the Utah Southern Railroad Company. Funds for this extension south of Salt Lake City were raised in the following manner: bonds of the Utah Southern Railroad were issued at the rate of \$18,000 per mile, to be subscribed for by the Utah Central stockholders at 80 cents on the dollar, in proportion to the amount of stock which each stockholder held in the Utah Central. The capital stock of this subsidiary Utah Southern road was \$15,000 per mile. This stock was issued as a bonus with the bonds, except that upon the first 75 miles of the extension 5 per cent was paid in on the stock.⁶ Substantially all of the par value of the capital stock and 20 per cent of the bond issue therefore represented water. Work on the Utah Southern was carried on during the late seventies, and early in 1880 the line was opened from Salt Lake City to Frisco.⁷

In 1880 the Utah Southern was consolidated with the Utah Central, and the new consolidated corporation became known as the Utah Central Railway Company. Its total length from Ogden to Frisco was about 277 miles. In 1901 this line was extended to Los Angeles, and is now known as the Los Angeles and Salt Lake Railroad, or the "Salt Lake Route."

The Oregon Short Line

The Union Pacific was for many years without a connection of its own with the Pacific Coast. It was wholly depend-

⁶ Pac. Ry. Com. Test., p. 2156, testimony of John Sharp.

⁷ Annual Report for 1879, p. 14.

ent upon the Central Pacific for a western outlet. The same men who controlled the Central Pacific later built the Southern Pacific as a competing transcontinental line; and in 1884 the Central Pacific was formally leased to the Southern Pacific Company. Partly to become independent of this Southern Pacific domination and partly as a speculation to develop the North Pacific Coast and secure its business, the Union Pacific directors determined upon an extension of their system to the northwest along the old Oregon Trail.⁸

In 1881 Congress passed an act incorporating the Oregon Short Line Railway Company.⁹ This company was to be a subsidiary of the Union Pacific. The right to subscribe to its securities was offered to Union Pacific stockholders in proportion to the amount of stock which each stockholder held. The projected road was to be bonded at \$25,000 per mile and its capital stock was fixed at the same figure. The bonds and one-half of the stock were offered for subscription to the Union Pacific stockholders, each subscriber being given for \$1,000, one Oregon Short Line bond of \$1,000, par value, and 5 shares, par value \$500, of Oregon Short Line Stock.¹⁰ One-half of the stock was retained by the Union Pacific for purposes of control. The Union Pacific guaranteed the annual interest on the bonds of the new road, so that no difficulty was experienced in floating this bond issue.

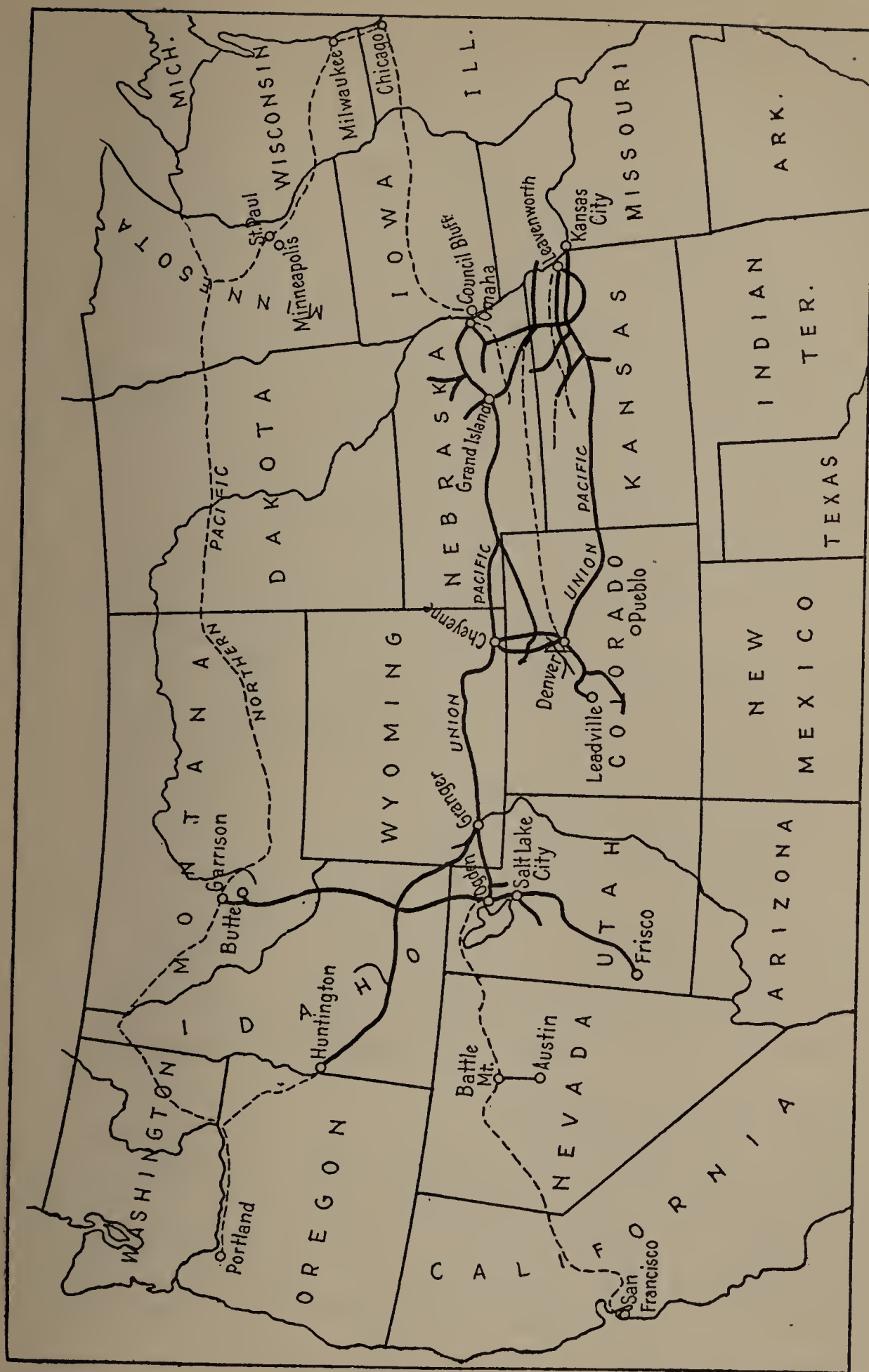
The road was built by the construction department of the Union Pacific Railway. Its cost was about \$25,000 per mile.¹¹ It runs from Granger, Wyoming, a station on the Union Pacific main line about 180 miles east of Ogden, to Huntington, Oregon, on the Oregon-Idaho state line, the total length of its main line being about 550 miles. Early in 1882 this line was completed to Huntington, and Huntington was connected with Portland, Oregon, by a railroad constructed by

⁸ The old Oregon Trail followed the Snake River across southern Idaho to eastern Oregon. The line of the Oregon Short Line closely follows this old emigrant trail.

⁹ 22 Stat. L. 185.

¹⁰ Pac. Ry. Com. Test., p. 93, testimony of C. F. Adams.

¹¹ *Ibid.*, p. 92, testimony of Adams.



Map of Union Pacific System in 1885

the Oregon Railway and Navigation Company. This combined line from Granger, Wyoming, to Huntington, and from Huntington to Portland was completed in December, 1884. At that time the Oregon Railway and Navigation Company was an independent corporation; its railway and navigation lines were, however, operated in harmony with the Union Pacific system. Subsequently, in 1887, the Oregon Railway and Navigation Company leased its track and equipment to the Oregon Short Line under an agreement whereby the latter company guaranteed the annual interest on the bonds and also guaranteed a 6 per cent annual dividend on the stock of the Oregon Railway and Navigation Company.¹²

The line of the Union Pacific now reached from Omaha to Portland. The three principal arteries of the system were the through Union Pacific-Oregon Short Line-Oregon Railway and Navigation Company line from Omaha to the north Pacific Coast, the former Kansas Pacific-Denver Pacific line from Kansas City to Cheyenne, and the Utah and Northern line from Ogden to Montana. Since its extension to Los Angeles, the Utah Central, or as it is now known, the Los Angeles and Salt Lake Railroad, has also become an important through line; but at this time it was merely a long feeder. During the period from 1877 to 1885 the Union Pacific also built an extensive system of shorter branches and feeders in the states of Nebraska, Kansas, and Colorado.¹³

Branch Line Construction

After the consolidation of the Union Pacific with the Kansas Pacific, in 1880, the Union Pacific Railway invested large sums in branch lines. Between 1877 and 1884, \$34,507,682.14 was so expended, of which \$24,818,386.23 were spent in 1881, 1882, and 1883.¹⁴ A small part of the

¹² Pac. Ry. Com. Test., p. 99, testimony of Adams.

¹³ A complete list of the auxiliary lines owned by the Union Pacific in 1887 is given at the close of this chapter in the form of an appendix.

¹⁴ Pac. Ry. Com. Test., p. 3970, reports of accountants.

cost of this constructional work was met out of the company's earnings; a larger part was carried as a floating debt; the balance was met out of the issuance of the following new securities: In 1879 the Union Pacific issued \$5,270,000 of collateral trust 6 per cent bonds secured by a pledge of a portion of the branch line securities in its treasury. Late in the year 1880 the Union Pacific Railway issued \$10,000,000 of new capital stock, which was sold at par. In 1883 the company issued additional collateral trust bonds amounting to \$6,000,000, which bore 5 per cent interest. These bonds were likewise secured by a pledge of a portion of the Union Pacific's branch line securities.¹⁵ The proceeds arising from the sale of these bonds and this stock were used partly for the purpose of constructing branch lines, and partly for the purpose of paying off portions of large floating debts which represented branch line construction.

These branches were in every case built or acquired under separate corporate organizations. The power of the Union Pacific and Kansas Pacific to consolidate had been expressly granted by statute; but with this exception the charter of the Union Pacific nowhere conferred upon it any authority to construct or acquire branches.¹⁶ In order to avoid this restriction it seems it was necessary to employ the device of separate subsidiary corporations. Ordinarily the Union Pacific, through its construction department, built each branch, and in return for its advances for construction received all or a portion of the securities of the branch line, just as any ordinary construction company. This was not done in the case of the Oregon Short Line, which was financed by a separate outstanding bond issue on which the interest was guaranteed by the Union Pacific. There were, however, relatively few branch line bonds, as such, outstanding; although \$10,000,000 of the

¹⁵ Annual Reports; Sen. Docs. No. 62, 54th Cong., 2nd sess. (serial No. 3469), pp. 22, 23.

¹⁶ Except the Leavenworth branch of the Kansas Pacific, from Leavenworth, Kansas, to Lawrence, Kansas.

capital stock of the Union Pacific and two separate series of Union Pacific collateral trust bonds, aggregating over \$11,000,000,¹⁷ represented expenditures for branches.

Value and Importance of Branch Lines

This branch line policy was at one time the subject of much adverse criticism. The branches were not covered by the government's lien, and their net earnings were not subject to the 25 per cent requirement of the Thurman Act. Many of these branches failed to earn their fixed charges and thus compelled the Union Pacific to make good the defaulted interest on their outstanding securities. The charge was freely made that the company's officials were interested in the securities of these subsidiary corporations, and were employing this device to divert the main line's assets and earnings away from the main line for their own private advantage. It was frequently asserted that the branch lines were not feeders but in fact "suckers," and that the policy of the management in building branch lines was seriously impairing the government's security for the ultimate repayment of its advances to the company. On account of the company's position as a debtor to the United States government this question of auxiliary and branch lines attracted much attention, and gave rise to much misapprehension and exaggerated statement, especially on the part of persons who were unfamiliar with practical railroad management.

It is now generally recognized that it is the local, not the through business which constitutes the chief source of a railroad company's gross receipts. At one time the through business gave to the Union Pacific a very much larger revenue than the local business; but this was no longer the case in the eighties. In 1884 about 80 per cent of the company's earnings were realized from local traffic.¹⁸ As a consequence of increas-

¹⁷ Not all of these collateral trust bonds were, however, outstanding.

¹⁸ Complete figures showing the relative decrease in through tonnage and the relative increase in local tonnage are published in the company's annual report for 1884, p. 14.

ing competition the percentage of gross earnings derived from through business declined steadily after 1880, so that the Union Pacific became more and more dependent upon local traffic for support. Local traffic is developed by the construction of "feeder" lines to tap the territory which would be otherwise too far distant from the main line to be reached. Branch lines assist the development of territory which might otherwise remain undeveloped, and at the same time they secure a certain amount of local business to the parent railroad against the inroads of competing lines.

While branch lines may be and frequently are unprofitable when considered by themselves, they may notwithstanding be a source of great profit when operated in conjunction with the main line, by reason of the interchanged traffic which passes over both the main line and the branch, which would be lost to the main line if the branch did not exist. It is the profit in this interchanged business which makes a system of branch lines desirable. Usually the net earnings of a branch line are relatively very much less than the net earnings of the main line. The cost of maintenance of way, terminals, and other overhead charges falls more heavily upon the branch line whose traffic is relatively light, than such expenses do upon the main line. On the other hand the branch furnishes interchanged business to the main line which would be otherwise lost.

Suppose the Oregon Short Line be considered as an illustration. A train of cars from the east, bound for local points on the Oregon Short Line, or for Pacific Northwest Coast points, is hauled all the way from Omaha to Granger on the main line of the Union Pacific. The profit to the Union Pacific from this long haul must be considered in estimating the value of the Oregon Short Line to the Union Pacific. The local earnings of the Oregon Short Line on business actually carried over its track by no means represent the value of this road as a feeder to the Union Pacific. During the period under

consideration, in the eighties, the Oregon Short Line's bonds, on which interest was guaranteed by the Union Pacific, were nearly all outstanding. Interest on the Oregon Short Line's total bond issue of \$14,495,000 amounted to \$896,700. From 1883 to 1886 the operation of the Oregon Short Line resulted in an annual deficit which averaged about one-third of the road's annual fixed charges. Notwithstanding this apparent deficit, there is little doubt that in fact this road was a positive advantage to the Union Pacific by way of business which was interchanged between the Union Pacific and the Oregon Short Line. In 1887 the president of the Union Pacific, Charles Francis Adams, estimated that the Oregon Short Line was worth to the main line about \$500,000 annually, above the defaulted coupons which were paid by the Union Pacific.¹⁹ This estimate may possibly have been somewhat exaggerated. Definite figures are difficult to obtain, as for many years no accurate record was kept from which the effect of branch line operation upon the system's income could be checked up. Later the Charles Francis Adams management gathered some fairly accurate statistics for the year 1886, from which it appears that in that year the operation of the Oregon Short Line resulted in a net gain to the Union Pacific of \$267,742.41.²⁰

The obligation of the Union Pacific Railway Company to pay the interest on bonds of the branch roads whose net earnings were insufficient to meet this interest was greatly lessened by the fact that considerably over half of these bonds were already in the Union Pacific treasury. Out of a total issue of \$39,272,000 of bonds of corporations subsidiary to the Union Pacific, only \$15,079,000 were afloat, including \$12,300,000 of Oregon Short Line bonds outstanding out of the total issue of \$14,495,000.²¹ The remainder, over \$24,000,000, were retained in the Union Pacific treasury. The total amount of branch line stocks and bonds which were owned by the Union

¹⁹ Pac. Ry. Com. Test., p. 979, testimony of C. F. Adams.

²⁰ *Ibid.*, p. 899, statement submitted by Comptroller Oliver W. Mink.

²¹ Annual Report, 1884.

Pacific yielded a small direct annual return of about 3 per cent on the company's entire investment in them, not including such profits as the main line realized out of interchanged traffic carried over it, according to the comptroller of the Union Pacific, Oliver W. Mink. For the year 1886 Mink prepared a statement from which it appears that the total gross earnings of the Union Pacific Railway from this interchanged traffic alone exceeded \$5,400,000, leaving out of account the earnings of the branch lines themselves.²² Mink estimated the expense of moving this traffic at about 40 per cent. Deducting this 40 per cent, the profit remaining was over three and a quarter million dollars. The value to the parent company of its investments in branch lines seems to have been as follows for the year 1886:²³

Net income of branch lines.....	\$1,446,123.26
60% of receipts from traffic interchanged.....	3,277,070.92
Direct and indirect income.....	\$4,723,194.18
Interest on branch line bonds afloat.....	1,080,465.00
Surplus, gain to the Union Pacific.....	\$3,642,729.18

The collateral trust bonds outstanding in March, 1887, which represented branch line investments, were as follows:²⁴

	TOTAL ISSUE	OUTSTANDING IN MARCH, 1887
6 per cents of 1879.....	\$5,270,000	\$4,541,000
5 per cents of 1883.....	6,000,000	4,567,000

Interest on the collateral trust bonds outstanding in March, 1887, amounted to \$460,810. Deducting this sum from the above figure, it appears that the net return to the Union Pacific from its branch line investments was in 1886 approximately \$3,181,919.18, or about 8 or 9 per cent upon their cost.

Unfortunately there is no way in which the accuracy of

²² Pac. Ry. Com. Test., pp. 616, 619, testimony of Mink.

²³ *Ibid.*, p. 899, statement submitted by Mink. These figures do not bear out Mink's statement that the investments in branch lines yielded a direct annual return of about 3 per cent on their cost. One per cent would be a nearer estimate.

²⁴ Commercial and Financial Chronicle, Investor's Supplement, March, 1887. Mink, in his estimates, took no account of the interest on the collateral trust bonds outstanding.

these figures can be checked up; but whether these particular figures are correct or not, practical railroad operation has demonstrated the soundness of a policy of branch line extension. There is hardly an important railroad in the country which had not followed this policy, as the map of any great system will show. To be sure, a number of decidedly unprofitable branches were unloaded on the Union Pacific by Gould, or came into the system as a result of an error of judgment on the part of the management. The policy of organizing subsidiary corporations instead of building branches directly was also liable to abuse, if there was any advantage to be gained therefrom by the officers of the parent company. But the sweeping statement that the auxiliary line system of the Union Pacific resulted in bleeding the main line for the benefit of the branches is not borne out with reference to the system as a whole.

Constructive Mileage Allowances and Net Earnings

Not only did many persons believe that this system of branches was weakening the government's security for the ultimate collection of its second mortgage; it was also freely charged that one other feature of the branch line policy diminished the company's annual percentage payments toward the Thurman Act sinking fund. This feature was the system of constructive mileage or arbitrary allowances which the Union Pacific was in the habit of making to its branches. It has usually been the custom for a line which receives the greatest relative benefit from traffic interchanged to make certain allowances upon an agreed basis of division to the line which receives the least relative benefit from traffic interchanged. Thus where a through rate is less than the sum of the local rates, a long line may allow a short line a greater share in the division of the through rate than would be afforded by a strict mileage prorate, or even by a prorate per rate; for the shorter line may operate at such a disadvantage that it carries the

traffic at a very much heavier relative expense per mile than does the longer line. So a road operating under peculiar physical difficulties might receive a similar arbitrary allowance in a division of the through rate.

For example the mileage divisions from New York to San Francisco are:

	PER CENT
Lines east of Chicago.....	29.43
Chicago to the Missouri River.....	14.82
Pacific roads	55.75

But the Pacific roads operate under certain physical disadvantages. Therefore in 1887 the through rates were actually divided:²⁵

	PER CENT
Lines east of Chicago.....	20
Chicago to the Missouri River.....	12
Pacific railroads	68

The Union Pacific itself adopted the same principle with reference to its subsidiary companies, and as a consequence the net earnings of the main line as they were reported each year were less than they would have been had these constructive mileage or arbitrary allowances not been made. The practice would have made virtually no difference since the branch lines were owned by the parent company; but whatever allowances were so made to the auxiliary roads escaped the 25 per cent requirement of the Thurman Act, as this act applied only to the subsidized portion of the road. The system of constructive mileage or arbitrary allowances was freely denounced as a device for evading the percentage clause of the law, and therefore a fraud upon the government; and while the question of whether such allowances should properly be deducted in order to arrive at the amount of the main line's net earnings was never passed upon by any court, it was believed by many that such allowances should be subject to a tax of 25 per cent.

²⁵ Pac. Ry. Com. Test., p. 1443, testimony of T. L. Kimball.

It seems, however, that the annual percentage payments of the company to the government were as a matter of fact increased by the constructive mileage system; for although the percentage on allowances made by the Union Pacific to its subsidiary companies was lost to the government, allowances made to the Union Pacific by roads east of Omaha were included in calculating the annual percentage. Thus for the month of July, 1886, the effect on the government's 25 per cent seems to have been as follows:²⁶

Under a mileage prorate the interchanged business would have been divided:

Eastern roads	\$472,187.13
Union Pacific main line.....	391,989.74

By the constructive mileage arrangement the division was:

Eastern roads	\$344,587.83
Union Pacific main line.....	470,450.33

Thus the Union Pacific gained the sum of \$78,460.59, all or substantially all of which was subject to the 25 per cent government assessment. During the same month, July, 1886, the Union Pacific divided its through rates to points on its auxiliary lines in such a way that the branch lines received \$284,804.20 instead of \$245,873.89, the amount they would have received under a mileage prorate. Thus the net earnings of the Union Pacific for the month of July, 1886, were diminished by only \$38,930.31 through the constructive mileage allowances which the parent line made to its branches.²⁷ There is no evidence to show that these allowances were excessive, or greater than the usual divisions between independent roads.²⁸

The uneasiness in regard to the practice of making constructive mileage allowance, and the sweeping criticisms of the

²⁶ Pac. Ry. Com. Test., p. 3962, tables submitted by O. W. Mink, Comptroller of the company.

²⁷ In 1887 President Adams declared that as the government received the benefit of a percentage on allowances made to the Union Pacific main line, the fact that the company subtracted from its net earnings the allowances it made to its branches should not be criticized as an attempt to evade the law. (Pac. Ry. Com. Test., p. 613.)

²⁸ In this point see the Report of the Government Directors for 1882.

company's branch line policy without discriminating between extensions which were made in good faith for the purpose of developing the country and benefiting the main line, and branch roads which were unloaded on the Union Pacific by its directors furnishes an example of the impracticability of levying upon the net earnings of a railroad company. It is not strange, in view of the company's general policy during the first fifteen or twenty years of its history, that there should be this prevalent misapprehension in reference to its branch lines, even though this widespread belief that the auxiliary line system as a whole was a private money-making device for the road's managers seems, except in a few instances, to have been without foundation.

Unprofitable Branches; Unrestrained Competitive Railroad Building

There were, however, several conspicuous examples of unfortunate branch lines. The St. Joseph and Western, which Gould had unloaded on the company in the course of the consolidation of 1880, proved to be a heavy burden. This road was subsequently, in 1885, abandoned to the bondholders. A reorganization followed, but the Union Pacific was the chief bondholder and therefore was able to retain control of it. After the road was reorganized its operation was more successful. Its name was changed to the St. Joseph and Grand Island Railway Company.²⁹ The Kansas Central road, which had come into the system at the same time, was another branch which, by reason of the fact that it was a narrow-gauge

²⁹ The original St. Joseph and Denver road ran from a point opposite St. Joseph, Missouri, to Hastings, Nebraska. Hastings was connected with Grand Island, a station of the main line of the Union Pacific, by the Hastings and Grand Island road. In 1877 the St. Joseph and Denver was reorganized. The property was divided and from that time until 1880 it was operated by two companies, the St. Joseph and Pacific, and the Kansas and Nebraska. These two last named companies were about 1880 consolidated into the St. Joseph and Western. After Charles Francis Adams became president of the Union Pacific, in 1884, the St. Joseph and Western was reorganized, and the reorganized company was consolidated with the Hastings and Grand Island, and with the St. Joseph Bridge Company. The new company, owning a road from St. Joseph, Missouri, to Grand Island, Nebraska, became known as the St. Joseph and Grand Island Railway. (See *Pac. Ry. Com. Test.*, p. 64, testimony of C. F. Adams; p. 238, testimony of James M. Ham; p. 264, testimony of William Bond.)

road, was for a long time of very doubtful value to the Union Pacific.³⁰ There were three other branches in Kansas and several lines in Colorado which appear to have been especially poor investments.

The period of the eighties was a period of unrestrained railroad competition, which encouraged much unnecessary railroad construction. It was a time of speculative railroad building, when roads were built far in advance of the ability of the regions through which they passed to support them. There was much unwarranted paralleling of roads, where perhaps one road was all that there was room for. This development was especially pronounced in the west. In 1886 Kansas led the other states of the Union in railroad construction; 1,678.04 miles of new railroad were built during that year within the borders of the state. In the same year Nebraska ranked third, with 628.08 miles of new railroad.³¹ Competition was becoming keener, and the Union Pacific, in order to protect its territory, was compelled at times to extend feeders in the states of Kansas and Nebraska, which might have otherwise been unnecessary and unwarranted.

The auxiliary lines which made up the Union Pacific system may be classed as either agricultural or mineral. The former were, generally speaking, in Kansas and Nebraska, the latter in states farther west. The business of the agricultural lines increased steadily as the country developed, even though such lines may have been originally constructed in advance of the country's needs, and even though their traffic was in many cases very light when they were first built, while the mineral roads were largely speculative. A line built to serve a particular mining locality carries a tremendous volume of traffic so long as the mines remain productive; but it has no other support, and if the mines "peter out" the business of the line collapses. The Union Pacific built or acquired a number of

³⁰ Pac. Ry. Com. Test., p. 76, testimony of C. F. Adams, who called the narrow gauge a "first-class nuisance." (*Ibid.*, p. 78.)

³¹ Pac. Ry. Com. Report, tables prepared by the minority commissioner, compiled from Poor's Manual of Railroads.

such speculative mineral branches. The speculative character of these mineral lines may be illustrated by the fluctuations in the net earnings of three of the better mineral lines from 1880 to 1886, inclusive:³²

YEAR	UTAH AND NORTHERN	ECHO AND PARK CITY	UTAH CENTRAL
1880	\$552,416.86	.....	.....
1881	602,618.77	\$34,093.30	.....
1882	905,308.37	38,966.88	\$1,638,545.23
1883	778,680.60	36,345.77	597,705.52
1884	884,947.03	53,353.45	483,431.85
1885	288,935.00	13,599.97	287,853.55
1886	459,418.00	5,660.17	312,964.69

The Denver, South Park and Pacific

The poorest branch line investment in the whole system was probably the Denver, South Park and Pacific road, a narrow-gauge mineral line, in Colorado. During the "boom" period in Colorado in the late seventies, some Colorado interests projected this line from Denver west. The road was first built from Denver to Buena Vista, Colorado, a distance of about 150 miles. The work was under three construction contracts with three successive construction companies.³³ In 1878, while the construction was still unfinished, Gould took an interest in the third construction company. He received soon afterward a dividend of \$571,600 in stock of the railway company upon his construction company stock. The par value of the entire capital stock of the Denver, South Park and Pacific road was \$3,500,000, and the entire issue was distributed as a bonus to the contractors. The actual cost of construction was represented by the bond issue, which amounted to \$12,000 a mile.³⁴

In November, 1880, Gould decided for some reason to buy this road. After some negotiation with the Denver capitalists who controlled about two and a half millions of the capital stock, Gould purchased, in addition to the shares he

³² Compiled from the Annual Reports of the Union Pacific Railway.

³³ Pac. Ry. Com. Test., p. 1736, testimony of Charles Wheeler.

³⁴ *Ibid.*, p. 1781, testimony of Wheeler.

already owned, 25,908 shares, par value \$2,590,800. The price paid was par. It seems that the Denver and Rio Grande interests were anxious at the same time to obtain control of the South Park road. Ex-Governor John Evans of Colorado, who represented the men then in control, succeeded in playing off against one another the Gould interests and the Rio Grande interests, and it was in this way that he and his associates were able to obtain this high price for their shares of South Park stock.³⁵

At first there were indications that this South Park road was to enjoy great prosperity. Its earnings were large. The mining "boom" enabled it, in 1879 and 1880, to meet the interest on its bonds with ease and to pay a 5 per cent dividend upon its stock which had been issued as a gratuity.³⁶ But this prosperity was short-lived. The "boom" declined rapidly toward the close of 1880. It seems that as early as January 7, 1881, Gould ascertained that the business of the South Park road was showing a sudden and an alarming falling off.³⁷ Gould evidently determined to run no risks, for he lost no time in unloading the bulk of his Denver, South Park and Pacific stock on the Union Pacific. An entry in his account current with the Union Pacific Railway shows that on January 25, 1881, he sold 30,993 shares, par value \$3,099,300, of South Park stock, practically his entire holdings, to the Union Pacific, and that for these 30,993 shares he received par.³⁸ In this way the Denver, South Park and Pacific road became a part of the Union Pacific system.

The South Park road had for a time a trackage agreement with the Denver and Rio Grande for the use of the latter's track from Buena Vista to Leadville, Colorado; but early in the decade from 1880 to 1890 this trackage agreement was

³⁵ Pac. Ry. Com. Test., p. 697, testimony of F. L. Ames; pp. 1852-54, testimony of John Evans.

³⁶ *Ibid.*, p. 1851, testimony of John Evans.

³⁷ *Ibid.*, p. 1859, letter of Evans to Gould.

³⁸ *Ibid.*, pp. 962-69, especially p. 969, copy of account; see also pp. 591-95.

terminated.³⁹ The Union Pacific thereupon extended the South Park road to Leadville. An extension was also built from Buena Vista to Gunnison, in central Colorado. The Union Pacific received new securities of the South Park road in return for this additional construction, and in this way it acquired more shares of capital stock and an issue of consolidated mortgage bonds which covered the entire South Park road, but which were subject to the first mortgage of \$1,800,000 on the first 150 miles. From the books of the Union Pacific it appears that the entire South Park line, including the line from Denver to Leadville and the branch to Gunnison, cost the Union Pacific nearly \$9,000,000, as the following table indicates:⁴⁰

30,993 shares of stock bought from Gould.....	\$3,099,300.00
30,358 shares issued for additional construction cost.....	1,265,412.49
\$2,797,000 of consolidated mortgage bonds issued for additional construction cost	2,746,905.86
\$1,800,000 of first mortgage bonds subject to which the pur- chase was made.....	1,800,000.00
Total cost to Union Pacific of South Park road.....	<hr/> \$8,911,618.35

For some reason the Leadville extension was so located that the line crosses the Continental Divide twice, notwithstanding the fact that Leadville is on the east slope. One of these passes is about 10,000 feet in elevation, the other is over 11,000 feet in elevation. The line was, and still is, known as the "High Line." Its operation was expensive because of the steep grades and the heavy snow fall. The road did not succeed in regaining the Leadville traffic, the bulk of which now went over the Denver and Rio Grande; there was no local agricultural business to sustain the line; many of the mines along the line "petered out" and were abandoned; its operation resulted in an increasing annual deficit; and in a very short time after it was acquired by the Union Pacific it became hopelessly in-

³⁹ *Ibid.*, p. 1859, testimony of Evans.

⁴⁰ Pac. Ry. Com. Rep., p. 65.

solvent. Interest upon the South Park bonds which were afloat averaged about \$130,000.00 annually. The operation of the South Park road from 1880 to 1884, inclusive, showed the following result.⁴¹

YEAR	NET EARNINGS
1880.....	\$996,621.49
1881.....	309,757.28
1882.....	377,469.60
1883.....	48,748.29
1884.....	—293,993.22 (deficit)

The South Park road has been dwelt upon because it was a conspicuous though not the only example of western speculative railroad building of the period. Charles Francis Adams has remarked that in no other state has there been so much ill-advised speculation in railroads as in Colorado.⁴² It would be a mistake, however, to suppose that because there were a number of such unfortunate branches in the Union Pacific system, some of which were unloaded on the company, some of which were built as speculation, that the branch line policy as a whole was a mistake from a financial standpoint, or that the auxiliary and branch lines merely served the purpose of diverting the road's earnings into improper channels so as to have the effect of weakening the government's securities for the ultimate repayment of its advances to the Union Pacific.

APPENDIX TO CHAPTER VIII

LIST OF SUBSIDIARY CORPORATIONS IN THE UNION PACIFIC SYSTEM, 1884

Colorado Central Railroad	Echo and Park City Railway
Denver and Boulder Valley Railroad	Golden Boulder and Caribou Railway
Denver, South Park and Pacific Railway	Junction City and Fort Kearney Railway

⁴¹ Annual Reports of the Union Pacific.

⁴² Annual Report for 1884. The portion of the South Park road running to Gunnison has proved so unprofitable that in recent years it has been abandoned. Parts of the "High Line" have also been at various times abandoned temporarily.

Kansas Central Railway	Oregon Short Line Railway
Lawrence and Emporia Railway	Salina and Southwestern Railway
Marysville and Blue Valley Rail- way	Solomon Railroad
Omaha and Republican Valley Railway	Utah and Northern Railway
Omaha, Niobrara and Black Hills Railway	Montana Railway
	Georgetown, Breckenridge and Leadville Railway

CHAPTER IX

THE ADMINISTRATION OF CHARLES FRANCIS ADAMS

Apparent Prosperity after Consolidation of 1880

The first three years following the consolidation of 1880 were years of great apparent prosperity for the Union Pacific Railway. Earnings were large. Notwithstanding the company's greatly increased capitalization, it continued to pay dividends upon its stock at the rate of $1\frac{1}{2}$ per cent each quarter, or 6 per cent per annum; and in the spring of 1881 the quarterly dividend rate was increased to $1\frac{3}{4}$ per cent, or 7 per cent per annum.

During the previous decade the Kansas Pacific had been the only competitor of the Union Pacific. The consolidation put an end to this competition; and although other lines were being rapidly extended westward, it was not until about 1883 that the completion of a number of competing lines began to make serious inroads into the earnings of the Union Pacific. After the consolidation, rates were for a time better maintained than before. The average rate per ton per mile on the Union Pacific main line advanced from 1.70 cents in 1879 to 1.81 cents in 1880, and upon the Kansas Division the average rate advanced from 2.09 cents in 1879 to 2.39 cents in 1880.¹ In 1881 and 1882 average rates on the Kansas Division advanced still higher, while on the main line average rates declined slightly from the rate in 1880.² The low competitive rates

¹ Annual Reports.

² The figures for four years are, in cents:

Year	Union Division	Kansas Division
1879	1.70	2.09
1880	1.89	2.39
1881	1.81	2.56
1882	1.74	2.63

between Colorado and the Missouri River yielded to higher uniform rates, with a corresponding effect on the earnings of both the Union Pacific main line and the Kansas Division of the Union Pacific.

But this was not the only factor which contributed to the road's prosperity during these years. The period of the early eighties was one of feverish speculative activity. The nation had recovered from the effects of the panic of 1873 and was passing through a "boom" period. Land speculation and speculation in mines were general throughout the west. Lands in western Nebraska and Kansas which had formerly been supposed unsuitable for agricultural purposes were now advertised as valuable farm lands. The inviting literature of land companies, or of the land departments of the land grant railways, assured prospective purchasers that the old notion that land west of the hundredth meridian was a barren desert was untrue, and that as a matter of fact the western prairie was an extremely fertile agricultural region. Alluring circulars telling of the marvelous productivity of this region induced many persons to migrate to the west. This was particularly so in the case of Kansas. Right at this time a succession of several years of unusually heavy rainfall gave color to the frequently asserted theory that the climate was changing.³ Western Nebraska and Kansas attracted many agricultural settlers; while mining speculation was active farther west.

The increasing earnings of the Union Pacific system are a good index of this agricultural and mineral boom. In 1880, 1881, and 1882 the earnings of the entire system (including auxiliary lines) were:⁴

YEAR	GROSS EARNINGS	NET EARNINGS
1880.....	\$25,066,893.77	\$12,944,954.11
1881.....	28,971,250.27	13,131,170.26
1882.....	29,430,318.70	14,188,357.32

³ On this point see especially the report of the Government Directors for 1879 (serial No. 2336, p. 158).

⁴ Annual Reports of the Union Pacific.

Another indication of the economic condition of the country, especially of the west, appears in the large sums which the Union Pacific expended in branch line construction. In 1880 the Union Pacific expended nearly \$4,000,000 for this purpose; in 1881, over \$7,500,000; in 1882, over \$9,250,000; and in 1883 nearly \$8,000,000.⁵

The stock market reflected the national fever for speculation. Union Pacific bonds commanded premiums of from 15 to 25 per cent. The stock, which was quoted in the neighborhood of par late in 1880, advanced steadily until it reached 131¾ on July 2, 1881. This high market value of Union Pacific securities was due not alone to the company's large earnings and its reputation as a regular dividend-payer, but was partly due to the universally high prices at which all securities were then being quoted on the stock market.⁶

Opening of Competing Lines; Decline of Earnings

Periods of feverish speculative activity generally yield to periods of depression. The speculative boom subsided toward the fall of 1883, and in May, 1884, the failure of the house of Grant and Ward precipitated a mild panic. Prices fell and a period of moderate depression followed.

As early as 1883 there were not wanting indications that the abnormal prosperity of the Union Pacific was soon to end. It was dependent upon the continuance of conditions which could not be permanent. The fact that this speculative boom period of the early eighties came to an end was not the only reason why the prosperity of the Union Pacific was threatened. The very fact that this was a period of speculation and busi-

⁵ Pac. Ry. Com. Test., p. 3970, reports of accountants.

⁶ An interesting comment upon the stock market situation appeared in the *New York Mail* on June 3, 1881, in a published interview with Cyrus W. Field, the projector of the first Atlantic Cable: "There will certainly be a panic. How soon I do not know, but the longer it is delayed the worse it will be when it comes. . . . Can any sane person believe that this condition of things can continue when stocks are seen rising in the market several per cent daily? . . . I have hardly seen a sane person since my return from Europe. Speculation is making people crazy. Why, when I went to Delmonico's for lunch this afternoon, I saw a throng of pale and anxious men congregated about a stock indicator, watching it as if it had been the pulse of a dying friend. It was a melancholy sight. Speculation is carried to an extreme which is sheer madness."

ness expansion encouraged the construction of new railroads which endangered the Union Pacific's monopoly.

While the Union Pacific was expanding to the northwest and to Montana, in Colorado, and elsewhere, other railroads were building westward with great rapidity. In 1881 the Southern Pacific was completed from the Pacific Coast to Deming, New Mexico, where it met the Atchison, Topeka, and Santa Fé road which connected Deming with Kansas City. By the junction of these two roads a second transcontinental line was formed. Already, in 1880, the Denver and Rio Grande had completed its narrow-gauge line from Denver to Ogden. For a time, however, the competition of these two lines, one from Denver to Ogden, the other a transcontinental line from Kansas City to the Pacific Coast, was not serious to the Union Pacific. Any loss that was sustained by the Union Pacific in the through overland business was more than offset by the increase in local traffic.⁷ The Rio Grande's effectiveness as a competitor was less than it would have been had it been a standard-gauge line. It was, moreover, until 1882 dependent upon the Union Pacific lines for an outlet to the east. In the spring of 1882, however, the Burlington road reached Denver. The Burlington, in conjunction with the Rio Grande, paralleled the Union Pacific throughout its entire length, that is to say, from the Missouri River to Ogden. In 1883 the Northern Pacific line was completed, and, as a consequence, not only the Pacific Coast business, but also the Montana business of the Union Pacific was affected. In the same year, 1883, the Atlantic and Pacific (now a part of the Santa Fé system) was finished from a connection with the Santa Fé line at Albuquerque to the Pacific Coast. In 1883 also the Southern Pacific "Sunset" line was completed from Deming, New Mexico, to New Orleans. Where there had been originally only one overland road there were now four—the Northern Pacific, the Union Pacific—Central Pacific, the Santa Fé—

⁷ Annual Report of the Union Pacific for 1881, p. 9.

Atlantic and Pacific, and the Southern Pacific. During the same years, that is to say in the first half of the decade from 1880 to 1890, the extension in Nebraska and Kansas of the Burlington on the south and the Northwestern on the north began to cut into the Union Pacific's local business.

About the same time there was a heavy falling off in mineral production, which had hitherto been an important source of revenue to the Union Pacific. In Colorado, where the Union Pacific had built or acquired an extensive system of branches to serve mining localities, the mining boom collapsed. It happened, too, that about 1883 the Horn silver mines at Frisco, in southern Utah, which had been furnishing a large volume of traffic to the Union Pacific, gave out.⁸

The inevitable consequence of the construction of new roads and of unrestrained competition was the decline of competitive rates. Railway tariffs were also in many cases arbitrarily reduced by state laws. Even during the seventies rates had declined somewhat, with occasional upward fluctuations, but after 1882 the declining tendency of rates became very much more marked. The average rates per ton per mile from 1882 to 1884, inclusive, were:⁹

YEAR	UNION DIVISION	KANSAS DIVISION	CONSOLIDATED LINE	SYSTEM
1882	1.74	2.63	1.89	2.21
1883	1.63	2.08	1.73	2.05
1884	1.40	1.81	1.51	1.80

In the company's annual reports the decline in rates, especially competitive rates, is frequently referred to as an important factor in bringing about a marked reduction in earnings.

The gross earnings of the Union Pacific system, including auxiliary lines, declined from \$29,430,318.70 in 1882, to \$28,629,222.80 in 1883, while net earnings fell off from \$14,188,357.32 to \$12,484,882.99.¹⁰ This decrease was particularly marked in the last six months of 1883. Toward the close

⁸ Pac. Ry. Com. Test., p. 85, testimony of C. F. Adams.

⁹ Annual Reports of the Union Pacific.

¹⁰ *Ibid.*

of the year 1883 the company's floating debt began to assume dangerous proportions. As a consequence of investments in branch lines the gross floating debt of the Union Pacific had reached over \$10,500,000 in June, 1882; while the company's quick assets, including cash, accounts receivable, and securities in its treasury, amounted to about \$6,000,000.¹¹ Early in 1883 the company issued \$5,000,000 of 5 per cent collateral trust bonds to retire this debt;¹² but the relief so afforded was only temporary, and the following year the debt began again to rise. The net floating debt at the close of the year 1883 was \$3,482,655.96, and three months later the debt exceeded \$5,250,000 after the proper offsets had been subtracted.¹³

End of Gould Control

By 1883 Jay Gould had unloaded his Union Pacific stock on the public, and his connection with the road as a director ceased in that year. The company had a reputation as a regular dividend-payer, and its securities had attracted many small investors. From a statement which was printed in the company's report for 1884 it appears that the great bulk of the stock was now held by small investors, women and trustees.¹⁴ Most of these stockholders had paid high prices, ranging from par to 131, for their shares. Charles Francis Adams, who was then president of the Union Pacific, estimated that by this time only about one-sixth of the company's stock was held on "Wall Street account." Adams is also authority for the statement that in 1885 not one stockholder in ten held stock at the time of the consolidation of 1880.¹⁵

The first half of the year 1884 was disastrous for the Union Pacific. In April of that year the quarterly dividend was declared as usual, but it was paid out of the company's

¹¹ *Ibid.*, 1882; Report of the Government Directors for 1882.

¹² Chron. 36:454 (1883). The total authorized issue was for \$6,000,000. (See Sen. Docs. No. 62, 54th Cong., 2nd sess. (serial No. 3469), p. 23.)

¹³ Annual Report for 1884, p. 13.

¹⁴ *Ibid.*, p. 111.

¹⁵ Remarks before the Pacific Railroad Committee of the House, printed in the company's Annual Report for 1885, p. 147.

accumulated surplus. The system's net earnings, which had amounted to nearly \$12,500,000 in 1883, amounted to \$3,296,230.86 for the first six months of 1884; that is, they were at the rate of about \$6,500,000 a year, only half what they had been in 1883. The operations of these six months resulted, after deducting fixed charges, in a deficit of \$383,614.38.¹⁶ On June 30, 1884, the net floating debt was \$6,900,177.95.¹⁷ The Union Pacific Railway, which had so long paid regular dividends, was therefore in serious financial straits. Its inflated capitalization was too heavy a burden to carry in times of business depression, though the depression of 1884 did not assume the proportions of a severe financial crisis. Moreover, the Union Pacific no longer enjoyed a virtual monopoly of the carrying trade of the west. It now shared its traffic with a number of competing lines which had been built for about \$25,000 per mile, and which could afford to cut rates to a figure which would not yield a profitable return upon the Union Pacific's capitalization. Under any circumstances the company would have found difficulty in maintaining its dividends; and at this juncture its relations with the United States government still further complicated the situation.

Attitude of Company Officers to Government

Whatever blame may attach to either party, the experiment of a quasi-partnership between the United States government and the Union Pacific Railway proved to be a failure. From motives of policy the railway, so far as can be seen, appears to have lived up to the strict letter of the law in respect to the railway's dealings with the government. On the other hand, it is impossible to justify its financial policy of paying dividends without providing for the maturity of its debt to the government. Indeed, while the company's officers were careful not to transgress the letter of the law, they nevertheless placed

¹⁶ Annual Report of the company for 1884, p. 7.

¹⁷ *Ibid.*, p. 5.

themselves in a position of hostility to the government. While responsibility for the continual friction between the company and the government did not lie wholly with the company, the company's policy had, up to 1884, stimulated the mutual suspicion and distrust which characterized the relations of the company and the government during the years when it was still in the government's debt.

The practice of the company's officers to disregard the interests of the United States government as not worthy of serious consideration is illustrated by the treatment which the government directors met with in 1882. The experiment of a board of government directors is especially interesting in view of a suggestion made a few years ago by the late President Ripley of the Santa Fé system, in which he proposed the appointment of a government director for every railroad in the country. In the case of the Union Pacific, the government directors appear not to have had any great influence in the road's management. Their chief function, it seems, was to make an annual report to the Interior Department regarding the road's condition. In their report for 1882 the government directors gave the following account of the treatment they received at the hands of the company's officers:

Nearly three months having elapsed after the making of the appointments without receiving any notice of a directors' meeting or any recognition from the stockholders' board, one of our number, Mr. Bromley, called at the office of the company in New York with the view of ascertaining, if possible, whether any functions attached to the office; and if so, what was their nature. He was treated with great courtesy by the chief executive officer of the company, who, however, informed him, somewhat to his surprise, that practically there were no functions; that the office was a "myth"; that the road and equipment belonged to the stockholders; that provision for the payment of the company's debt to the Government had been made by the "Thurman bill"; and that as a matter of fact, the Government had no further concern with the direction of the road and its management. . . . It was evidently

his opinion that the Government directors had neither duties, responsibilities, nor power, and that aside from taking a pleasure trip over the road, nominally for the purpose of inspection, there was nothing for them to do. . . .

This succinct definition of the functions of the office from the point of view of the company's chief executive officer did not hold out large promise of usefulness in our official position to either the Government or the company. While there was no lack of courtesy or even cordiality towards the representative of the Government during the interview it was quite manifest that the company's officers had no disposition to magnify the office of Government director, nor any intention of imparting to us any more information concerning the condition of the road and the conduct of its affairs than was already accessible through other sources to the Government and the public.

In such important proceedings as the issuance of the company's collateral trust bonds, the making of traffic contracts with other roads and the declarations of dividends, as well as other matters falling within the province of directors, the government directors were not consulted. The natural consequence of the company's policy, as this report observes, was to awaken suspicion that the manner in which its affairs were conducted would not bear exposure, whether in fact such was or was not the case.¹⁸

Adverse Congressional Action Threatened

The operation of the Thurman Act was generally unsatisfactory. On account of the high premium on government bonds, the sinking fund yielded only about 2 per cent annually, and the company was entirely justified in protesting against the investment of this fund in United States bonds. As payments were made upon the basis of net earnings, disagreements between the company and the government as to what

¹⁸ It seems the government directors had been themselves lax at times. "The previous Government Directors gave very little attention to the meetings," said one of the company's officers in explaining why their presence had not been thought necessary at executive committee meetings. The law provided that one government director should be a member of every standing committee of the board.

net earnings were, continued.¹⁹ The company was hampered in its ordinary legitimate business transactions, and was constantly attacked in Congress and out, by persons who, owing to their ignorance of railroad operation, were not competent to express opinions on the subject, as well as by speculators whose object was to "bear" the company's securities. The company's policy had exposed it to merited criticism, but the situation was not improved by extravagant hostile assertions which were freely made in regard to the Union Pacific. That the company's policy should be discussed in the newspapers and in Congress was inevitable, since the government received this contingent payment of 25 per cent of the company's net earnings. Such details of railway management as branch line construction, pooling arrangements, constructive mileage allowances, rebates, stock and bond issues, and traffic contracts and guaranties were discussed, not with reference to their general effect upon the community, but with respect to the effect which they had upon the government's 25 per cent.

While the history of the Union Pacific thoroughly demonstrated the need of general railroad regulation, nevertheless even intelligent regulation applied to one road and not applied to its competitors would place that road at an unfair disadvantage in competing with roads not hampered by regulation. Moreover, many of the attempts at general railroad regulation during the sixties and seventies were unwise. Especially unfortunate was much of the legislation respecting the Pacific railroads. The original acts of 1862 and 1864 were obscure. The form in which the Thurman Act was passed was ill advised, notwithstanding the propriety and necessity of compelling the Pacific Railroad companies to provide sinking funds to provide for the payment of their debts to the government. For several years after the passage of the Thurman Act, Congress left the Pacific railroads alone; but in the session

¹⁹ The recent Esch-Cummins Railroad Law has adopted the net earnings principle. In view of the history of the Union Pacific it will be interesting to watch the operations of the Esch-Cummins Law.

which met in the fall of 1883 several bills and resolutions were introduced against the Pacific railroads, especially the Union Pacific. The question of the companies' increasing debts to the government was considered during that session by the Judiciary Committee of the Senate, and various propositions for refunding these debts, or for increasing payments into the sinking fund, were discussed in both houses of Congress.

The Supreme Court's decision in the net earnings case²⁰ did not put an end to disputes over the way in which net earnings should be ascertained. The decision had been announced only a short time when a new dispute arose. The company claimed the right to deduct such amounts as it expended for certain new construction and equipment, and refused to make payments into the sinking fund unless these deductions were allowed. For the year ending 1881 the government claimed a balance of \$901,837.03 due on account of the sinking fund. Demand was made upon the company for the payment of this sum, but the company insisted that there be first subtracted from its net earnings, before calculating the amount of the government's 25 per cent, a sum which would make a difference of \$306,477.07 in the amount required by law to be paid by the company into the sinking fund.²¹ Neither would yield to the other and nothing was paid by the company. By 1882 the difference between the conflicting claims of the government and of the company in respect to the amount to be paid by the company into the sinking fund amounted to nearly \$700,000.²²

In due course the dispute was referred to the Court of Claims for adjustment, but no decision was made until October, 1884. In the meantime the company made no payments to the sinking fund. Early in 1884 the government claimed that \$2,446,557.14 were due the sinking fund for

²⁰ See *supra*, p. 135.

²¹ Correspondence between United States Railroad Commissioner Armstrong and Secretary of the Interior Teller, printed in the Annual Report of the Railroad Commissioner for 1883, pp. 31 ff.

²² Report of the Railroad Commissioner for 1883, pp. 31 ff.

the three years preceding, while the company asserted that this amount should be reduced by \$788,173.43.²³ When in the spring of 1884 the Senate Committee on the Judiciary began the consideration of the Pacific railroad question, the fact that no payments had for over three years been made to the sinking fund at once attracted the attention of the Committee. The Committee, of which Senator Edmunds, of Vermont, was chairman, threatened to make a very damaging report and to urge Congress to take drastic action. During the same spring a bill to increase the annual payments of the Pacific railroads into the sinking fund to 45 per cent had been under consideration in the House. Congress was not inclined to be friendly to the Pacific railroads, and various influences were at work which resulted finally, on the 17th of June, 1884, in the passage of this bill by the House.²⁴ It was an ill-advised measure, and under existing conditions had it been carried out would probably have driven the Union Pacific into bankruptcy. Nevertheless the submission of such a report as the Judiciary Committee of the Senate threatened to make might have induced the Senate to pass this bill.

Election of Adams to Presidency; Temporary Adjustment with Government

Such was the situation in the middle of June, 1884. In consequence of increased competition, lower rates, and a general business depression, the company was in financial difficulties. More competition was threatening the road on all sides. The company's relations with the government were uncertain, and damaging legislation was threatened. Union Pacific stock, which had sold at 131¾ on July 2, 1881, dropped to 28 on June 28, 1884.

On June 19, two days before the House of Representatives passed the bill requiring additional payments into the sinking

²³ *Ibid.*, 1884, p. 4.

²⁴ Cong. Record, 48th Cong., 1st sess., p. 5324.

fund, Sidney Dillon resigned from the office of president of the Union Pacific. To succeed Dillon, the board of directors, on June 18, 1884, elected a prominent New England railroad man, Charles Francis Adams, Jr. Mr. Adams was the son of Charles Francis Adams, who had been minister to England during the Civil War, and he was the grandson of President John Quincy Adams. He represented the great bulk of Union Pacific stockholders, the men and women who held small holdings which they had bought as investments. Adams had had an interesting career, both in military and civil life, and as a writer before his election as President of the Union Pacific. He was well known as an economist and as a student of railway problems; he had written many articles on railway subjects; fifteen years earlier he had published his well-known essay, "A Chapter of Erie," which exposed certain transactions of Gould and Fisk; he was the author of a work on the subject of "Railroads and their Problems"; he had been appointed a member of the Massachusetts Railroad Commission in 1868; in 1878 he had been appointed a government director of the Union Pacific Railroad. Subsequently he became a stockholder in the Union Pacific, and in 1882 he was elected a director of the company.

In June, 1884, Adams became president of the Union Pacific. He faced a difficult task. His predecessors had not alone burdened the road with oppressive fixed charges, but their policy of hostility toward the United States government was now bearing fruit. The first act of the new administration was to ward off the impending attack on the company in the United States Senate, as a preliminary to reaching some permanent settlement with the government. There seems to have been apprehension on the part of the government lest, in case the government should win the net earnings case then pending in the Court of Claims²⁵ and should then attempt to

²⁵ Another suit involving over \$2,000,000 was at that time pending in the Court of Claims in regard to the amount the company was entitled to charge for carrying the mails.

collect the judgment which it would obtain against the company, the company would be without funds to pay this judgment; for its dividends left but a small surplus in its treasury. In a letter to Senator Hoar, one of the members of the Senate Judiciary Committee, President Adams offered, provided the Committee would refrain from making an attack on the company in its report to the Senate, to discontinue the payment of dividends for the balance of the year 1884, within which time it was expected that the net earnings case would be decided. Adams also offered to the government the right to withhold, pending the settlement of the questions involved in the net earnings dispute, all payments on account of government transportation over the unsubsidized as well as over the subsidized lines of the entire Union Pacific system. He proposed further to pay at once into the United States Treasury the sum of \$718,814.60, the government's maximum claim for the year 1883.²⁶

The Committee accepted this proposal of President Adams and resolved to postpone the consideration of matters in connection with the sinking fund on condition that the company comply with his offer.²⁷ The principal question seems to have been that of security for the payment of the large sum which would be due the government in case it should win the net earnings case, and the offer of President Adams seemed to afford sufficient security. The company paid the stipulated sum, \$718,814.60, into the Treasury of the United States, and passed the usual July dividend. The Court of Claims decided the net earnings case against the company in the fall of 1884.²⁸

Improved Condition of Company

The new management now applied itself to the task of placing the company on its feet financially. To check the

²⁶ Report of the Railroad Commissioner for 1884, p. 6.

²⁷ *Ibid.*, p. 5.

²⁸ *Union Pacific Railway Company v. United States*, 20 Ct. Cl. 70.

declining tendency of the road's net earnings many economies were introduced. Formerly there had been a lack of responsible local management along the line of the road. This lack was now supplied. Notwithstanding the repeated protests of the government directors in their annual reports, the Union Pacific had theretofore been managed from Boston, and the directorate either could not or did not familiarize itself with the real needs of the road. The new administration now placed responsible executive authority in the general manager, whose office was at Omaha. Moreover, a new office was created by the appointment of T. J. Kimball as traffic manager.²⁹ Curiously enough, there had been no such officer before. The government directors reported in their annual report for 1884 that every device in the way of economy which scrupulous care could suggest or ingenuity could invent which did not adversely affect the road's physical condition, was now adopted.³⁰ The operation of the company's rolling mills at Laramie, Wyoming, was discontinued, since it was found no longer profitable for the company to reroll its own rails. A few worthless branches were abandoned to their creditors. Much of the money which had formerly gone to pay dividends was now applied toward the extinguishment of the floating debt, and much was expended in improving the physical condition of the property. In this regard the road, especially the main line, had been fairly well maintained, although much could be done towards improving it. The Idaho branches, the Oregon Short Line and the Utah and Northern, were, however, in very poor condition. Their business could not be properly handled with the imperfect facilities then at hand.³¹ In all such cases, wherever the

²⁹ Government Directors' Report for 1884, House Exec. Docs. No. 79, 48th Cong., 2nd sess. (serial No. 2302), p. 3.

³⁰ *Ibid.*, p. 5.

³¹ In the company's Annual Report for 1886 (pp. 158-9) is a special report setting forth the inefficient manner in which the Idaho division of the system was managed up to that time. Locomotives ran after dark without headlights; often a piece of a man's shirt was used for signals; and it was the rule, not the exception, to see a caboose with only one tail light. "No attempt," says the report, "was made to keep up running repairs, except to simply get an engine over the turntable and out on the road, trusting

physical condition of the system was not up to the proper standard, defects were now rapidly repaired.

About \$6,500,000 were realized by the sale of some securities in the company's treasury.³² The sum so obtained was applied toward the extinguishment of the floating debt. The net floating debt was reduced from \$6,900,177.95 on the 30th of June, 1884, to \$3,237,696.53 at the close of the same year.³³ During 1885 the floating debt was still further reduced, until at the close of that year it amounted to \$1,861,445.40. During the following year, 1886, the company's notes were all paid, so that the management was able to report that for the first time in the company's history there were no bills payable maturing at the close of the year. On December 31, 1886, there was a balance of cash and cash resources of over \$1,250,000 above all floating liabilities.³⁴ Nor was there any marked increase in the company's capital obligations. In June, 1884, the total funded debt afloat of the Union Pacific system, including such bonds of the auxiliary lines as were outstanding, was \$146,588,427.87; while at the beginning of the year 1887 this total amounted to \$148,233,092.96, an increase of only \$1,644,665.09.³⁵

This result is particularly remarkable in view of the company's critical situation in the early summer of 1884, and in view of the continued misfortunes which befell it during the remaining years of this decade. Though the last six months of 1884 were much more prosperous than the first six months of that year, the decrease in the road's annual net earnings continued during 1885 and 1886, notwithstanding the fact that the gross earnings of the entire system increased slightly, as the following table shows:³⁶

to 'luck' that she would make the trip. When an engine did give out, she had only enough labor and material put on her to enable her to get out again, hoping she would last a few months." (See also Report of the Government Directors for 1884, House Exec. Docs. No. 79, 48th Cong., 2nd sess. (serial No. 2302), p. 12.)

³² Pac. Ry. Com. Report, p. 67.

³³ Annual Report for 1884, p. 13.

³⁴ *Ibid.*, 1886, p. 19.

³⁵ Annual Report of the company for 1886, p. 23.

³⁶ Annual Reports.

YEAR	GROSS EARNINGS	OPERATING EXPENSES	NET EARNINGS	EXPENSE RATIO
1884	\$25,657,290.41	\$14,868,115.20	\$10,789,175.21	57.95%
1885	25,674,674.75	15,987,233.53	9,687,441.22	62.27%
1886	26,280,185.89	17,412,213.77	8,867,972.12	66.26%

This decrease in net earnings is attributable to several causes. The period of unusual rainfall in western Nebraska and Kansas was followed after 1885 by several years of severe drought. The optimists who had before insisted that the climate of this region was changing now found that they were mistaken.³⁷ The company's reports refer frequently to crop failures, owing to the scarcity of rainfall, as one cause of the continued low annual net earnings. In 1885 serious labor troubles at Rock Springs, Wyoming, interfered with the operations of the company's coal department. Most serious of all, however, from the standpoint of the Union Pacific, was the constant increase in competition, which reduced competitive rates all along the line.

At this time the Union Pacific was at a distinct disadvantage in competing with such lines as the Burlington, the Missouri Pacific, or the Northwestern. Not only had the Union Pacific been capitalized at double the cost of its original construction; millions of dollars of water had been added to its capitalization by the consolidation of 1880. Unprofitable branches had been in a number of instances forced upon it.³⁸ It had, moreover, actually cost more than \$50,000 a mile to build and equip the Union Pacific, while competing lines cost only about half as much. This difference was due partly to the high prices of labor and materials during and immediately after the Civil War; partly to the speed with which the road was built and the peculiar difficulties under which the work was carried to completion; and partly to the fact that while

³⁷ Because of the drought many counties of western Kansas were depopulated during the last half of this decade.

³⁸ The Adams management abandoned several small branches, but the Kansas Central, the St. Joseph and Western, and the Denver, South Park and Pacific were retained, as well as other branches of doubtful value. The St. Joseph and Western, after its reorganization into the St. Joseph and Grand Island, was no longer a burden but a source of profit.

56-pound iron rails cost from \$130 to \$160 per ton in the sixties, Bessemer steel rails weighing 70 pounds to the yard cost only about \$35 a ton in the eighties.

Hostility of Local Communities to Union Pacific

There is considerable evidence which tends to confirm the statement that the company's earlier policy had the effect of stirring up a feeling of antagonism toward the road among the communities along the line upon whose shipments the road depended for its earnings. The report of the government directors for 1884 calls especial attention to the unpopularity of the Union Pacific among its patrons. That this observation was correct is indicated by the bulk of the testimony of local shippers which was taken in 1886 and 1887, in two important government investigations.³⁹ During the many years when the Union Pacific had a monopoly, the traffic department was, according to the government directors, "conducted on the theory that the Union Pacific would always be able to maintain its monopoly, and upon the principle that corporate extortion is a performance in which a railroad management may indefinitely indulge with impunity."⁴⁰ It is probable that complaints regarding rates would have been common even had rates been much lower than they were. But whether or not the company's rates were in fact unreasonable, high rates were not the only cause of dissatisfaction. In the days when it was the custom for railroads to grant rebates, it was frequently asserted by railroad managers, and it is doubtless true, that in the struggle for competitive business it was impossible for a railroad not to grant rebates or make discriminations. This argument, however, would not hold in the case of a road which was not required to meet competition. Yet notwithstanding its monopoly, the Union

³⁹ The Cullom Committee investigation, which resulted in the passage of the first Interstate Commerce Law, was made in 1886. For the Pacific Railway investigation of 1887, see below, p. 232.

⁴⁰ Report of the Government Directors for 1884, House Exec. Docs. No. 79, 48th Cong., 2nd sess. (serial No. 2302), p. 7. This report calls the past history of the company a "travesty on corporation management." (*Ibid.*, p. 9.)

Pacific was in the habit of following the same practices as other roads did at that time. The company's high open tariff rates, its practice of granting rebates to favored shippers, and the discriminations it made between localities (these discriminations were, it must be admitted, in many cases entirely reasonable), resulted in an aggravated discontent among the local communities along the line. As a result of these methods there developed a strong adverse public sentiment. This sentiment took the first chance which was offered to divert competitive traffic to other lines.

The Adams administration tried to rectify this condition. One of the worst enemies of the Union Pacific, Edward Rosewater, the editor of the *Omaha Bee*, told the Cullom Committee on Interstate Commerce, in 1886, that the Adams administration was a great improvement on the former management.

Since the new administration, under Mr. Adams, has come in, they have done away with a great deal of obnoxious abuses. They have done a great deal to change and to smooth down the differences or difficulties between the people of this state and their road.⁴¹

Local Political Activity; Free Passes; Rebates

The free pass system had for many years been a prominent cause of complaint. Adams made a determined, if not entirely successful attempt to change this evil system. "Ever since I have been president of the Union Pacific," said Mr. Adams, "I have been laboring to cut it down. It has been one of the great annoyances I have met with, but I have been foiled in nearly every attempt."⁴² Adams was a determined opponent of the pass system. He called it an "outrage," and said it "mixes itself up with newspapers, politics and everything." The Union Pacific under the Adams administration

⁴¹ Cullom Report on Interstate Commerce, Test., p. 1126, testimony of Edward Rosewater.

⁴² *Ibid.*, p. 1219, testimony of C. F. Adams.

was much less generous in the issuance of passes than were its competitors.

As is well known, passes may be a fruitful source of political corruption. Not only passes but other influences seem at times to have been used by the Union Pacific in local Nebraska, Kansas, and Colorado politics. To how great an extent the railroad controlled local politics would be hard to say. Many unsupported charges were made to the effect that Union Pacific officials were in the habit of corrupting legislatures in one way or another; but it is always difficult, if not impossible, to confirm such statements.⁴³ Much of the evidence in this regard is hearsay, is unreliable, and doubtless much exaggerated. Yet even from the testimony of the company's officers and lobbyists it is clear that other means than "moral suasion" were used in influencing legislatures.⁴⁴ Members of the legislatures were freely entertained at the company's expense. "They were a lot of thirsty fellows there," said one of the company's attorneys in reference to the Nebraska legislators at Lincoln, Nebraska.⁴⁵ After he became president, Adams put a stop to this form of political activity on the part of the company; or if such activity was carried on to any extent, it was done without his knowledge and against his instructions.⁴⁶

Unfortunately Adams, as he himself declared, found that he was powerless to remedy single-handed the evils of the pass system, or the system of granting rebates. The pass system, while it is usually associated with political activity, was also a form of rebate; and in the struggle of competing lines for business the railroad that refused to give rebates lost the traffic. Adams frankly admitted that rebates and passes were freely given to favored shippers in order to meet

⁴³ Pac. Ry. Com. Test., pp. 1334-1417, testimony of Rosewater; p. 533, testimony of Isaac M. Raymond; p. 1764, testimony of Nathaniel Hill; pp. 1949-63, testimony of W. B. Felker; p. 1971, testimony of John Campbell; and the testimony of other witnesses before the Pacific Railway Commission.

⁴⁴ *Ibid.*, pp. 1307-13, testimony of George Crawford.

⁴⁵ *Ibid.*, p. 1706, testimony of John P. Usher.

⁴⁶ *Ibid.*, p. 1996, testimony of Adams.

like concessions which other railroads offered; and he declared that if a scheme could be devised whereby all rebating might be ended, it would be a great boom to all railroads. Speaking of rebating, Adams said:

Gradually this demoralizing spirit of low cunning has pervaded the entire system. Its moral tone is deplorably low. This is the root of the trouble as it exists to-day. That healthy mutual confidence which is the first essential to prosperity in all transactions between man and man does not exist in the American railroad service taken as a whole.⁴⁷

The granting of rebates and free passes therefore continued, notwithstanding Adams' earnest attempt to change the system. This was something that could not be done by any one road.

Increased Competition; Pools; Decline of Rates

The decade of the eighties was a period of fierce railroad competition and rate wars. Competitive rates were in a continued state of uncertainty. The pooling agreements which usually followed rate wars or which were made to prevent them, could not be legally enforced. Railroad companies treated with one another as independent free agents and pooling contracts only held so long as these independent agents were willing to respect them. There was no outside force to compel the different companies to respect the pools to which they themselves agreed. In 1887 pools were declared illegal by the Interstate Commerce Law. Prior to 1887, pools, although they were frequently disregarded, did to some extent maintain rates, but average rates show a steady decline, notwithstanding occasional violent upward fluctuations. After 1885 the value of business which passed over the Union Pacific system again increased, but the very slow gain in gross earnings when compared with the relatively large increase in tonnage, and consequent increase in operating expenses, is an indication of the downward trend of rates. The

⁴⁷ Cullom Report, Test., p. 1211, testimony of Adams.

average rate per ton per mile on the entire Union Pacific system in 1885 was 1.72 cents. The rate declined every year thereafter, until it reached 1.28 cents in 1888. The following year the average rate advanced to 1.40 cents, and declined again after 1889.⁴⁸ The effect of carrying a heavier tonnage at lower rates may be seen in the figures representing the ratio of operating expenses to gross earnings. In 1880 operating expenses represented 48.36 per cent of the company's gross earnings, in 1885, 62.27 per cent, and in 1890, 71.57 per cent.⁴⁹

In 1886 the tonnage carried by the Union Pacific increased greatly, but net earnings actually decreased. The reason for this decrease was a bitter overland rate war which broke out in February, after the dissolution of the transcontinental pool. This pool had included the Union Pacific, the Central Pacific, the Santa Fé lines, the Burlington, the Rio Grande, the Southern Pacific and its subsidiary, the Galveston, Harrisburg and San Antonio, and the Northern Pacific, as well as the Pacific Mail Steamship Company. Under the pool the railways named had been in the habit of paying a monthly pool balance of \$80,000 to the steamship company, in order to prevent such a reduction in water rates from the east to the Pacific Coast as might injure the transcontinental business of the railways.⁵⁰ The payment of pool balances, such as this Pacific Mail subsidy, was frequently criticized not alone on the ground that pools tended to prevent competition and were in restraint of trade, but also on account of the fact that as such pool balances were deducted by the Union Pacific in computing its net earnings, the company's annual payments into the Thurman Act sinking fund were correspondingly diminished. The company's critics were mistaken, however, in believing that the revenues of the road were diminished by these payments which

⁴⁸ Annual Reports of the company.

⁴⁹ *Ibid.* There are, however, indications that the higher ratio of operating expenses to gross earnings was partly due to better maintenance of the property by the Adams administration.

⁵⁰ Pac. Ry. Com. Test., pp. 1140 ff.; p. 1111, testimony of Adams.

were made to carry out pooling agreements. The following figures of the Union Pacific's earnings from transcontinental business indicate the effect of the disruption of this transcontinental pool upon the company's earnings:⁵¹

YEAR	GROSS EARNINGS FROM PACIFIC COAST THROUGH BUSINESS	TONS CARRIED ONE MILE, PACIFIC COAST THROUGH BUSINESS	RATE PER TON PER MILE
1885	\$1,797,527.12	169,469,646	1.06
1886	1,334,249.47	228,661,421	.58

A comparison of the average transcontinental rate per ton per mile for the first four months of 1885 and 1886 shows the following result:⁵²

YEAR	JANUARY	FEBRUARY	MARCH	APRIL
1885	.77	1.19	1.15	1.19
1886	1.26	.98	.43	.40

Net earnings of the Union Pacific proper, not including branches, declined from \$8,404,676.31 in 1885, to \$7,522,707.02 in 1886; while the corresponding figures for the entire system were \$9,687,441.22 and \$8,967,972.12, respectively.⁵³

The transcontinental rate war ended late in the spring of 1886. The following year, 1887, notwithstanding heavy crop failures in Kansas and Nebraska, which resulted in a decline in the tonnage of agricultural products of 13.8 per cent,⁵⁴ the net earnings of the Union Pacific system increased to over \$10,500,000.

Financially the company was in fair condition after 1885, notwithstanding the fact that its earnings continued to be low—too low to warrant the resumption of dividends. Thanks to the efficient Adams management, the insolvency which had threatened the Union Pacific in June, 1884, had been averted. A net floating debt of nearly \$7,000,000 in June, 1884, was changed to a net surplus of cash and quick assets above all

⁵¹ Annual Report of the company, 1886, p. 21.

⁵² *Ibid.*, p. 24.

⁵³ Pac. Ry. Com. Test., p. 4802, reports of accountants; also the company's annual reports.

⁵⁴ Annual Report for 1887, p. 10.

floating liabilities of over \$1,250,000 at the close of the year 1886. This surplus was greatly reduced the following year, 1887, but at the close of the year 1888 it exceeded \$5,000,000.⁵⁵ During the period between June 30, 1884, and December 31, 1886, over \$8,300,000 were spent in physical improvements.⁵⁶ The steady decline in net earnings during 1884, 1885, and 1886 was, however, disquieting. Although after the improved showing of 1887 there appeared a possibility that dividends might be resumed "upon a conservative basis,"⁵⁷ in 1888 net earnings again decreased; and in that year the surplus earnings of the system after fixed charges and interest guaranties on branch line bonds outstanding had been paid showed a decline from nearly \$3,000,000 to \$1,500,000. This was partly a result of the continued drought in Kansas and Nebraska.⁵⁸ Since the system's surplus earnings showed such a heavy falling off, the management concluded that the results of the closing months of 1888 and the outlook for 1889 did not justify the resumption of dividends.

Continued Congressional Hostility

It is now necessary to return to a consideration of the road's relations with the government. These relations continued to be unsatisfactory to both sides. Although a temporary settlement had been made in 1884, new difficulties recurred from time to time. The Adams administration, realizing the situation, worked hard to bring about a permanent settlement of the vexatious questions involved in the company's relations of debtor to the government. Especially unsatisfactory was the net earnings clause of the Thurman Act. The real solution, as Adams pointed out to committees of Congress at this time, was to refund the debt at once on some basis which would substitute fixed annual payments for

⁵⁵ Annual Reports.

⁵⁶ Annual Report of the company for 1886, p. 24.

⁵⁷ *Ibid.*, 1888, p. 9.

⁵⁸ *Ibid.*

percentage payments; but the necessary legislation could not be obtained because of a general antagonism to the company, an antagonism which failed to distinguish the difference between the Gould management and the Adams management.

Many small holders had bought the securities of this company as investments, and it was proper that their rights should be considered. In America whenever the public conscience has been aroused over some real or fancied abuse, the first demand seems generally to be to punish someone. In the case of the Union Pacific, the easiest persons to reach were the individuals who were at the time interested in the Union Pacific Railway. The memory of the Credit Mobilier was still fresh, and many people believed, as they had good reason to believe, that great frauds had subsequently been committed in the Union Pacific management. That the transactions of Gould were worthy of punishment, there can be no question. As in the case of the Erie, so also in the case of the Union Pacific, Gould showed that he belonged to that class of speculators which may be termed railroad wreckers; that is, men who manage and control railroads for the sole purpose of stock speculation and of reaping large gain therefrom for themselves. The consequences of Gould's transactions had now fallen upon many individuals who were in fact innocent purchasers of stock that had been sold to them at inflated values. These individuals had had no connection with either the Credit Mobilier or with the consolidation of 1880 or any other of the questionable transactions of earlier managements. A large number of congressmen, forgetting where the real blame lay, felt that the company should be punished, and were not desirous of reaching a permanent settlement which should be for the best advantage of all concerned. There were not wanting men who sought to vent their hostility against railroads in general by opposing everything which the Union Pacific proposed, merely because the Union Pacific proposed it. There was also an element which attacked the company and introduced bills and

resolutions which were contrary to the company's interest, not for the bona fide purpose of righting existing wrongs, but solely for speculative purposes, in order to affect the company's credit and the value of its securities.⁵⁹

Instead of being allowed to conduct its own business in its own way, subject to such regulations as Congress imposed upon all railways, the Union Pacific was constantly hampered and annoyed by attacks which made the situation worse, instead of better, and which prevented a solution of the problem. The chief difficulty lay in the percentage method of determining the company's annual payments into the sinking fund.

Constant charges of iniquitous conduct, accompanied by endless threats of investigation, do, and cannot but have an injurious influence upon the credit of the company and the value of its securities. . . . So long as the Government requirements are measured by a percentage of the net earnings of the company, the Government and the Union Pacific will be engaged in a series of litigation.⁶⁰

Bills and resolutions aimed at the Union Pacific were being constantly introduced in Congress. For example, during the session from 1885 to 1886 the following bills were introduced in one house or the other :

Seven bills relative to the indebtedness of the Pacific railroads.

A bill to prevent the sale of the roads before the indebtedness to the United States was paid.

A bill to authorize the use of the proceeds of the sinking fund to build branches.

Three bills to forfeit the unearned land grants of the Pacific railroads.

Five bills to subject the Pacific Railroad land grants to taxation.

⁵⁹ That such was the purpose of many of the attacks on the company can hardly be doubted. Many of the proposals made in the form of bills or resolutions were without merit, and the stock quotations indicate their effect upon the market value of Union Pacific securities.

⁶⁰ Annual Report of the company for 1885, p. 14.

A joint resolution to investigate the Pacific railroads.

A House resolution to investigate the accounts of the Pacific railroads.

A House resolution to investigate the Kansas Pacific and Union Pacific.

A House resolution of inquiry relative to the Pacific railroads.

Two bills to authorize the Pacific railroads to construct branch roads.

A bill authorizing the Union Pacific to make running arrangements with the Cheyenne and Northern Railway.

A Senate resolution to investigate the Union Pacific.

A House resolution to investigate the Union Pacific.

A House resolution to prosecute the officers of the Union Pacific.

It should not be inferred that all of these proposed bills and resolutions were without merit; in fact, the contrary is true of a number of them. But the very fact that the government of the United States should sustain such relations with one railway, or with any number of railways, as to bring forth such a degree of legislative activity of the character which has been indicated was in itself an indication of the state of the public mind on the subject, and of the great interference and annoyance to which, however well intended, the Union Pacific was subjected. A certain amount of blame attaches to both sides for the existing situation. From every point of view the situation was unsatisfactory. The sinking fund had proved a complete failure to provide for the eventual liquidation of the company's debt to the government. To June 30, 1885, the Union Pacific had paid in \$5,301,895.06 to the sinking fund. By reason of the premium paid for government bonds, the income of this sinking fund averaged less than 3 per cent per annum.⁶¹ Thus a large sum of money was tied up in an unprofitable investment. The constant introduction

⁶¹ Report of the Commissioner of Railroads for 1885, p. 4.

of bills relating to the company made the situation of the company uncertain, and seriously handicapped it in its legitimate business transactions. A permanent settlement upon business principles, a settlement which would terminate the peculiar relations between the company and the government, was demanded by the interests of both the company and the government.

What to do with the Pacific railroads was indeed a difficult question to answer, and one sufficiently perplexing even had it not been necessary to reckon with two additional factors, namely, a blind prejudice based on ignorance against refunding the debt, in the belief that such a course would confer some improper advantage upon the roads, and the interests of a certain class of speculators who preferred the existing state of uncertainty, and who therefore exerted their influence against the adoption of any plan for permanent settlement.

Alternative Proposals of Settling Pacific Railroad Debts

The first of the bonds issued to the Union Pacific would begin to mature in 1895, about ten years distant, and the entire debt would become due by 1899. Judging by the sums which had already been repaid, the debt of the Union Pacific to the government would amount at maturity to about \$50,000,000 in excess of the road's aggregate annual payments under the different statutory provisions. It was not expected that this debt could be paid when it should become due. One of four things would result: The government might pay off or assume the first mortgage and itself operate the road; the government might foreclose its second mortgage, and in this way recover a portion of its advances to the road; the government might execute a release to the company; or the government might grant an extension of time under some plan for refunding the debt. There was much discussion and speculation as to which of these four courses should be adopted. Each plan had its advocates, and each plan had its objections.

The government's lien covered only the main line of the Union Pacific Railroad, and the first $393\frac{15}{16}$ miles of the old Kansas Pacific.⁶² The branch lines were not included, nor some valuable terminals; and it was an open question whether the government's mortgage covered the bridge at Omaha. The road which the government might have acquired by foreclosure would therefore have been a much more limited system than the Union Pacific system as it then was. The loss of the branches, however, would have been partly offset by the fact that many of them had no outlet except to the main line, and also by the fact that any disadvantage which might result from the loss of such branches as had other outlets might have been remedied by the government's unlimited means to build its own feeder lines. The real opposition to acquisition of the road by the government, either by foreclosure of its mortgage or otherwise, lay not in any question regarding the extent of the government's lien, but in the reluctance of the greater part of the nation to permit the national government to make such radical departure in economic policy. The danger of financial loss to the government and the fear of incompetent management loomed large in the eyes of many persons. Private ownership of railroads was generally believed to be the best course for the nation, and it was deemed unwise to change this policy. In the eighties, Congress and the people did not have before them the example of the Panama Canal, which has shown that the dangers of government ownership are probably less than had been generally supposed. Nevertheless, when, after the recent war with Germany, a similar situation was again presented and the question raised whether to retain the roads taken over and operated by the government during the war, the idea of continued government operation of our great railroad systems was again rejected; since the general opinion, strengthened by widespread dissatisfaction with the recent Railroad Administration, is still against government

⁶² As well as 100 miles of the Central Branch Union Pacific.

ownership and operation of railroads. In the eighties it was generally believed to be inexpedient and unwise for the government to acquire and operate the Union Pacific Railway.

The second alternative—foreclosure and sale—would, it was feared, result in partial or complete loss to the government. That a sufficient sum could be realized by a foreclosure sale to pay off the first mortgage and also repay the government its advances was not anticipated.

The third alternative—that the government execute a release of its unpaid claims on the ground that the advantages resulting from the road's completion far outweighed the loss of the subsidy—would have severed the anomalous relations between the United States and the railway company; but aside from the loss of some \$50,000,000 which were legally due the government, it would be a dangerous precedent for the government openly to permit the diversion by speculators of a vast subsidy to their private use, and to set the seal of official approval upon that corporate mismanagement which had brought the Union Pacific into the financial predicament in which it now found itself.

The fourth plan—that the debt be refunded at a lower rate of interest, each annual payment to be fixed—was probably the least unsatisfactory arrangement. The adoption at this time, that is to say, in the eighties, of some carefully worked out plan of refunding which would terminate the disputes which were continually recurring was the only plan of settlement which at that time seemed likely to result in the ultimate payment of the company's debt to the government. Viewed from the standpoint of debtor and creditor, this plan offered the most satisfactory solution for both parties. Refunding was favored not alone by the company, but by government officials and other men who had studied the whole situation with a view to reaching the best and fairest solution. As early as 1882 the United States Commissioner of Railroads had

recommended the refunding of the debt.⁶³ The report of every Commissioner of Railroads since 1882 made the same recommendation. The government directors in their annual reports favored the plan. To be sure, refunding would not be financially so advantageous to the government as a prompt cash payment in full; but there seemed to be very little likelihood that the company would be able to pay its debt at maturity.

There were two objections to refunding. One was that to make concessions to the company appeared to recognize as valid the acts of the Credit Mobilier, and the transactions of Gould, which had brought about the existing situation. While there was force in this objection, nevertheless there were other considerations which should be taken into account. The company was in 1885 no longer controlled by Gould. There was a vast difference between the Adams management and the Gould management. "I by no means defend all the acts or methods of the Union Pacific managements of the past," said Mr. Adams early in 1886. "No one criticized these more sharply than I then; no one realizes the consequences of them so constantly now."⁶⁴ Refunding, which necessarily involved a reasonable extension of time for the payment of the debt, was a not unreasonable concession to the new stockholders, as well as a sound financial settlement from the standpoint of the government.

The other objection lay in the opposition of local communities along the line of the road, who had a real grievance against the high local tariffs which were necessary to permit the company to meet its inflated interest charges. These communities felt that if the debt were refunded, the annual payments to the government would be one influence against rate reductions. It was in this section of the country where there was the strongest sentiment in favor of foreclosure, which, it was hoped, would "squeeze out the water" in the

⁶³ Report of the Commissioner of Railroads for 1882, pp. 12, 16.

⁶⁴ Remarks before the Pacific Railroad Committee of the House, printed in the company's Annual Report for 1885, p. 150.

road's capitalization, and so make feasible lower local rates.

As refunding was not as a matter of fact adopted in the case of the Union Pacific, it is impossible to say what would have resulted had this course been followed. The probability is, however, that, notwithstanding the objections there were to the plan, refunding the debt would at that time have been an equitable and fairly satisfactory solution of a difficult problem.

Proposed Outhwaite Refunding Bill

On April 26, 1886, the Committee on Pacific Railroads, through its chairman, Representative Outhwaite, of Ohio, unanimously reported a bill for the refunding of the Pacific railroad debts.⁶⁵ This so-called Outhwaite bill made provision for ascertaining the "present worth" of the debt at that time, and required the companies to retire the debt by means of fixed annual payments. The debt was to be extended for seventy years and was to bear interest at $3\frac{1}{2}$ per cent. The Pacific railroad companies were to be required to make semiannual fixed payments to the government, the fixed amount in the case of each company to be ascertained in a manner provided by the bill. The intention of the bill was that each company should, by means of 140 equal semiannual fixed payments extending over a period of seventy years, meet the interest at the rate of $3\frac{1}{2}$ per cent per annum upon the "present worth" of the debt, and in addition retire the principal within seventy years. During the same session a bill embodying the same general principles, but differing in certain details from the Outhwaite bill, was favorably reported in the Senate by Senator Hoar from the Committee on the Judiciary.⁶⁶ Consideration of the Senate bill was postponed, pending the action of the House on the Outhwaite bill.

It would not be easy at this distance to determine the

⁶⁵ Cong. Record, 49th Cong., 1st sess., p. 3844.

⁶⁶ *Ibid.*, p. 856.

merits of the details of either of these two bills; but the general principle of refunding was sound. Many, if not a majority of the representatives favored the passage of the Outhwaite bill, but the opposition was able to delay its consideration from time to time. A certain element of speculators was opposed to its passage and, if we may accept as true the statements of President Adams, exerted considerable influence to defeat the bill.⁶⁷ There was also an element which, remembering the Credit Mobilier and other railroad "scandals," was more anxious to punish someone for the acts of former administrations of the Union Pacific than accept the situation as it was and seek the best solution for all parties concerned. The mere fact that the Union Pacific was known to favor the Outhwaite bill was to them sufficient cause for opposing it.

Another group demanded that a thorough investigation precede the passage of any act for the settlement of the Pacific railroad debts. Charges that the Union Pacific was insolvent and that its management was corrupt and incompetent were freely made. Such charges necessarily injured the company's credit. It was asserted that Mr. Adams had been put forward merely to quiet the opposition to the company, and that he was a mere tool in the hands of Gould, who was asserted to be still the controlling influence in the Union Pacific's councils. Many such statements and other statements of like import appeared in newspapers and in congressional debates. As a matter of fact, such charges and statements had no foundation when applied to the Adams administration. Adams' position was definitely announced that whatever might be revealed regarding former administrations, the Union Pacific in 1886 had nothing to fear from an investigation into its management at that time. So far as information is at all available, it is now safe to say that the internal management of the Union Pacific at this time was conducted upon principles of economy and efficiency, and that its affairs were administered in accord-

⁶⁷ Annual Report of the company for 1886.

ance with sound business methods. Adams professed willingness to submit the affairs of the Union Pacific to a searching investigation, and offered to aid such investigation so far as possible, if the results of the inquiry would settle permanently, upon whatever basis the investigators should determine, the relations of the company with the government.⁶⁸

The Outhwaite bill came finally before the House for consideration on the 5th of June, 1886; but the dilatory tactics of its opponents prevented its passage.⁶⁹ The whole Pacific railroad question went over to the short session of the forty-ninth Congress. During that session, which met in December, 1886, railroads received much attention. The act creating the first Interstate Commerce Commission was passed in the spring of 1887. The Pacific railroad question was frequently discussed, but no action was taken upon the proposition to refund the companies' debts to the government. In January, 1887, the *New York World* made some serious charges in reference to the management of the Central Pacific, alleging that that company's officers had made a practice of legislative bribery. The effect of these charges seems to have been to strengthen the element which demanded an investigation of the Pacific railroads. Congress, during the closing days of the session, passed an act "authorizing the investigation of the books, accounts and methods of railroads which have received aid from the United States, and for other purposes."⁷⁰ This act provided for the appointment of a Commission of three men whose duty was to make a thorough investigation of the Union Pacific, the Central Pacific, the Central Branch Union Pacific, and the Sioux City and Pacific. This act made one concession to the companies; it provided that funds in the Thurman Act sinking fund might, at the discretion of the Secretary of the Treasury, be invested in company

⁶⁸ Annual Report of the Union Pacific for 1886, p. 11 (copy of letter of Adams to Senator Edmunds).

⁶⁹ Cong. Record, 49th Cong., 1st sess., pp. 5316-38.

⁷⁰ 24 Stat. L. 448.

first mortgage bonds, instead of in bonds of the United States.⁷¹

Pacific Railroad Investigation of 1887

The act was approved by President Cleveland on March 3, 1887. The work of investigation started immediately. President Cleveland appointed as members of this Commission, Governor Robert E. Pattison, of Pennsylvania, chairman, and E. Ellery Anderson, of New York, and David T. Littler, of Illinois. The inquiry was thorough. Practically every detail of the history and management of the Pacific railroads was carefully investigated. A corps of expert accountants examined the books and records of the companies while the members of the Commission were hearing oral testimony. The investigation commenced in the early spring of 1887 and continued throughout the summer and part of the fall. The consolidation of 1880 received much attention and the facts elicited by the testimony of Jay Gould, Russell Sage, Sidney Dillon, and other officers and directors of the company are conclusive evidence that the terms of that consolidation were without justification, whatever might be said as to the advisability of consolidation had the terms been reasonable. The question of branch lines and constructive mileage allowances, and their effect upon the road, was also carefully examined. Attention was not alone directed to the distinctive features of the history of the Union Pacific and the other bond-aided roads; the more general features of the railroad question, pools, rates, rebates, discriminations, competition, the long and short haul, were thoroughly investigated. The testimony, as printed, fills nine volumes, of which the first four and portions of the other volumes relate to the Union Pacific.

In the fall of 1887 the Commission reported the results

⁷¹ The annual income upon an investment in company first mortgage bonds was about 2 per cent higher than the income of an investment in government bonds. The Union Pacific had frequently asked that the funds in the sinking fund be invested in company first mortgage bonds instead of in government bonds.

of its investigation. A majority and a minority report were submitted. Commissioners Anderson and Littler submitted the majority report. They reported:

1. That while the consolidation of 1880 might have had a beneficial result, the methods by which it was obtained must be condemned, and that the terms of the consolidation placed a heavy additional burden upon the Union Pacific.

2. That the branch line policy of the Union Pacific was financially sound and indispensable to the road's prosperity, although the acquisition of a number of branches had not been economically justified, but had resulted from the manipulations of the management.

3. That so far as the physical condition of the Union Pacific was concerned, "the railways above described (the Union Pacific and branches) are fully provided with terminal facilities, side tracks, station-houses, and railway equipment, and with the exception of the shops, machines, and tools at Omaha, represent a well-built and well-equipped property, which is fully able to discharge all the services that may be required of it."

4. That while no dividends had been paid contrary to the strict letter of the law, the payment of dividends without providing for the company's debt to the government and in the face of an increasing floating debt could not be justified.

5. That the general service on the road was good, except in a few cases.

6. That rebates had been freely granted and pooling agreements entered into, but that the interest of the government in the company's net earnings had not been injuriously affected thereby, whatever might be said of the evils of the practice of allowing rebates and the effect upon the community.

7. That "the evidence established the frequent use by the officials of the Union Pacific Railway Company of money and passes for the purpose of influencing legislation," and that while no direct proof of actual bribery could be found, money

had been spent in maintaining lobbies, and in "argument, persuasion and entertainment."

8. That while the acts of preceding administrations should be severely condemned "in our judgment, it (the Adams administration) is fully and entirely exonerated from the condemnation to be passed on the transactions of other roads and relating to other periods. We are satisfied that this administration has devoted itself honestly and intelligently to the herculean task of rescuing the Union Pacific Railway Company from the insolvency which seriously threatened it at the inception of its work; that it has devoted itself, by rigid economy, by intelligent management, and by an application of every dollar of the earning capacity of the system to its improvement and betterment to place that company on a sound and enduring financial foundation."

9. That the companies' debts to the government be refunded.

In support of the recommendation that the companies' debts be refunded, the majority commissioners submitted drafts of four refunding bills, one for each of the Pacific railways. The plan they proposed was similar to the plan of the Outhwaite bill.

The minority commissioner, Governor Pattison, differed from the majority in four particulars. He refused to join in the opinion expressed by the majority commissioners regarding the Adams administration. He denounced the company's branch line policy as extravagant, as a means of improperly diverting the company's earnings by the constructive mileage factor, and as an extreme example of the speculative railroad development of the period. In this view he stood almost alone; of the testimony taken by the commissioners, all that worthy of serious consideration was to the contrary. Governor Pattison also denounced in very strong terms the system of rebates and discriminations, and held up this system as one example of the way in which this

company was in the habit of breaking faith with the people. In this particular Pattison, while rightly indignant at the system of rebates, was not altogether fair in placing the whole burden of the blame for this system upon the Union Pacific. As for the Adams administration, it was clear that it was not responsible for the practice of rebating; Adams had been compelled to accept conditions as they were. Finally, the minority commissioner reported against refunding the debt to the government; he failed, however, to offer any affirmative proposition as an alternative.

The report of this Pacific Railway Commission was an authoritative discussion of the Pacific railway situation by men who spent their entire time for over half a year in carefully investigating the facts and personally examining the men who had managed the company's affairs. When President Cleveland submitted their report to Congress he urged the necessity of settling the questions at issue once and for all time. "The public interest," said President Cleveland, "urges prompt and efficient action." Prompt and efficient action, however, is not usually a characteristic of legislatures. The report of the Commission was printed, together with the nine volumes of testimony, and many fruitless debates over the Pacific railroad question occurred during the two sessions of the fiftieth Congress, from 1887 to 1889. No result was reached, however, and the situation continued as before, the debt to the government increasing every year and the time of maturity rapidly drawing near.

In 1888 the Adams administration decided that the debt should not increase further through the interest account. It was decided to set aside a sum of money or securities to be each year paid over to the American Loan and Trust Company of Boston, as trustee, this sum to be equal to the deficiency between the company's payments into the sinking fund and the annual interest paid by the government.⁷² This

⁷² Annual Report of the company for 1888, p. 10.

additional sinking fund—which should have been established many years earlier—was, however, not maintained; for surplus earnings were not large the following year, 1889, and it seemed advisable, on account of the pressing necessity for certain physical improvements, to defer this plan for a time.⁷³ The plan was adopted too late. The company was just about able to meet its fixed charges and maintain its property. Surplus earnings available for such a sinking fund or applicable to dividends, that is, the surplus remaining after the payment of fixed charges and interest guaranties upon outstanding branch line bonds, showed a falling off from 2½ per cent upon the capital stock in 1888 to 1.9 per cent in 1889. This falling off resulted principally from the failure of some of the subsidiary lines to earn the interest on their bonds outstanding. The decrease in amount was from \$1,551,911.90 in 1888 to \$1,144,904.03 in 1889.⁷⁴ It was therefore decided not to diminish still further the relatively small surplus now available for permanent improvements, and the situation remained unchanged.

Branch Line Consolidations; Oregon Railway and Navigation Company Purchase

The Adams administration had continued the policy of building feeder lines. The system grew in mileage and it soon became cumbersome to manage through so many different corporate organizations. A number of subsidiary lines were merged into one organization when, on August 1, 1889, the Oregon Short Line, the Utah and Northern, the Utah Central, and several shorter lines were merged into a new subsidiary corporation which was called the Oregon Short Line and Utah Northern Railway.⁷⁵ During the same year, 1889, this new corporation, the Oregon Short Line and Utah Northern Railway, purchased control of the Oregon Railway

⁷³ *Ibid.*, 1889, p. 9.

⁷⁴ *Ibid.*, p. 37.

⁷⁵ Annual Report of the company, 1889, p. 11.

and Navigation Company. The reasons for this step were: First, the money necessary to purchase control of this company could be borrowed at 5 per cent, while under the existing lease⁷⁶ the Oregon Short Line and Utah Northern guaranteed a dividend of 6 per cent on the stock of the Oregon Railway and Navigation Company, so that a saving in interest of 1 per cent per annum was effected to the extent of the shares bought by the Oregon Short Line and Utah Northern Railway; and second, that there was danger that the Northern Pacific might acquire control of the Oregon Railway and Navigation Company, to the disadvantage of the Union Pacific system. About one-half of the stock of the Navigation Company was purchased by the Oregon Short Line and Utah Northern Railway, at a cost of a little over \$12,000,000.⁷⁷ It was apparently intended to issue a new series of collateral trust bonds secured by the stock of the Oregon Railway and Navigation Company to cover this purchase,⁷⁸ but for some reason this was not done. A large part of the funds necessary for this \$12,000,000 investment was raised by the company's ordinary bills payable, whereby a large floating debt was again created. In place of a surplus of cash and quick assets of over \$5,000,000 in 1888, the company's gross floating debt exceeded \$7,000,000 and its net floating debt amounted to \$4,489,563.60 at the close of the year 1889.⁷⁹ The Oregon Railway and Navigation Company was an important acquisition; but there was danger in this assumption of such large floating liabilities.

A number of other consolidations of subsidiary corporations were made. The largest of the new corporations was the Union Pacific, Denver and Gulf Railway. This company was a consolidation of the old Colorado Central, the Georgetown, Breckenridge and Leadville Railway, the Den-

⁷⁶ See *supra*, p. 182.

⁷⁷ Annual Report, 1889, p. 11.

⁷⁸ *Ibid.*, p. 12.

⁷⁹ Annual Report of the company for 1889, p. 74.

ver, Marshall and Boulder Railway, and some other short branches together with a system of lines extending from Denver to the Gulf of Mexico; this last named system of lines had not before been a part of the Union Pacific system. This consolidation was completed on April 1, 1890.⁸⁰

One result of extensive branch line investments was the steady and rapid increase of the floating debt. The company's net unfunded liabilities fluctuated during the year 1890, and for a time were greatly reduced, but at the close of that year they exceeded \$7,000,000, the largest they had ever been in the company's history.⁸¹

Retirement of Adams; Return of Gould Control

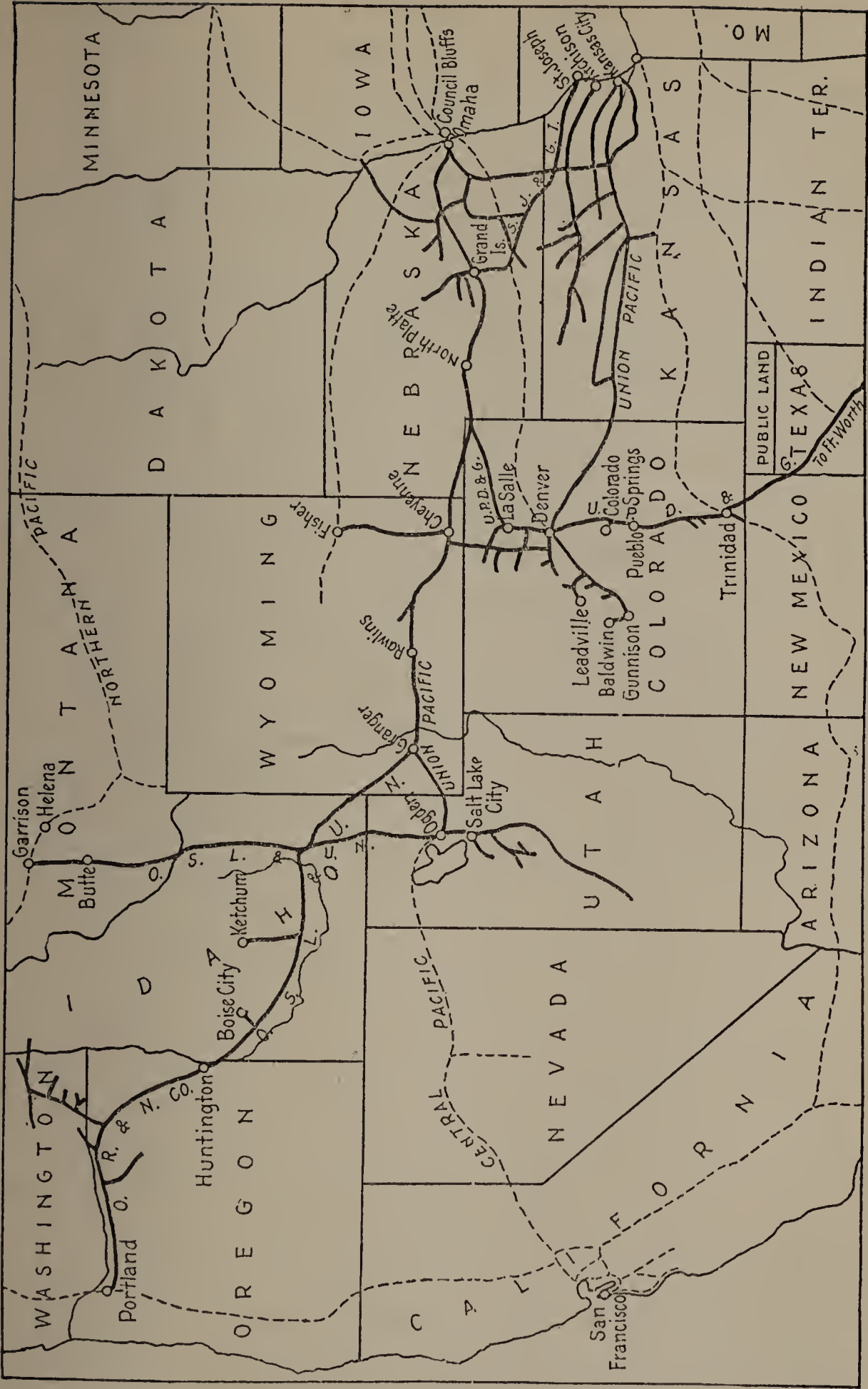
What plans the Adams administration had to meet this situation is a matter of conjecture; for late in the year 1890 the management again changed. Toward the close of that year Gould again became a power in the Union Pacific. The company's stock had in the middle of the eighties advanced materially over the low figure at which it had been quoted in June, 1884, in the expectation that the Adams management would again place the company upon a dividend basis. But the uncertain policy of Congress with respect to the Pacific railroads had a depressing influence upon the stock. Earnings fell off on account of increased competition and crop failures; and after all hope for the resumption of dividends had disappeared in 1890, the stock again became attractive to speculators.⁸² Control of the Union Pacific again passed into the hands of Jay Gould. Thereupon Adams resigned his office, on November 24, 1890. He was followed by Sidney Dillon, the same man who preceded him in this office. Jay Gould and Russell Sage again became directors.

The six and a half years during which Charles Francis

⁸⁰ Annual Report of the company for 1889, p. 35. These lines were substantially the same as those of the present Colorado and Southern road.

⁸¹ *Ibid.*, p. 11.

⁸² Union Pacific ranged in the neighborhood of 65 during the greater part of the Adams administration. In the fall of 1890, however, Union Pacific fluctuated in the neighborhood of 45.



Map of Union Pacific System in 1891

Adams occupied the office of president of the Union Pacific Railway form an interesting and unique chapter in American railroad history. It has often happened that men in control of great railroads have not operated their properties as railroads primarily, but have preferred to further their own ends by skilful stock manipulations in order to make profits on the stock market, so that as a result the interests, not alone of the public but of the security-holders, are sacrificed. President Adams administered the affairs of the Union Pacific Railway upon the theory that he was the trustee of the stockholders and that it was his business to protect their interests. It seems to have been his aim so far as he was able to remove the causes of complaint which existed between the railway company and the communities which were served by it, and to foster more friendly relations between them. A sweeping reform of railroad practices was not possible, however. The practical necessities of railroad management and the demands of competition at that time prevented any one company from abandoning rebates, passes, and discriminations. Above all, Adams was unable to remove the chief difficulty with the whole situation, the excessive capitalization of the Union Pacific.

CHAPTER X

RECEIVERSHIP AND REORGANIZATION

Issue of Collateral Trust Notes

A leading financial journal observed, in 1891, that the new Gould-Dillon management came into office upon the same issue which six and a half years earlier had turned out the former Dillon management and brought the Adams administration into office, namely, the problem of a large and unwieldy floating debt.¹ This comment is somewhat misleading. The retirement of Mr. Adams did not come about as a result of a disagreement among opposing factions of shareholders in regard to the corporation's financial policy. Adams learned in the fall of 1890 that the Gould interests had again come into control of the Union Pacific, and when he discovered this to be the fact he resigned. Had the Adams administration continued in office it would doubtless have provided in some way for the new floating debt, which represented the company's investments in auxiliary lines, especially the Oregon Railway and Navigation Company, and the Union Pacific, Denver and Gulf. It is nevertheless a coincidence that just as the former Dillon management had left a large floating debt to the Adams management, so now the Adams management, when it went out of office, left a net floating debt slightly larger than the net floating debt which had faced the company in June, 1884.

The Adams administration had been able to reduce the former floating debt and finally wipe it out altogether, partly out of the company's surplus earnings and partly by the sale of securities in the company's treasury. The problem of meeting the new floating debt was more difficult now than it had

¹ Chron., 72: 1239.

been before. The company's net surplus earnings, after paying all fixed charges and deficits of branch lines did not, in 1891, provide a large margin. The company was, moreover, not willing to retire the floating debt by disposing of any considerable amount of its branch line securities at a sacrifice. It was nevertheless imperative to make some provision for taking care of the company's large unfunded obligations. The directors during the summer of 1891 evolved a plan for the temporary retirement of the floating debt. This plan was materially different from the manner in which the same problem had been met before, by the Adams administration.

Under the new plan a series of 3-year 6 per cent collateral trust notes was to be issued, and part of this issue to be used to retire the floating debt.² These notes were to be issued at a discount of $7\frac{1}{2}$ per cent to such holders of the floating debt as were willing to accept them. Holders of the floating debt who refused to accept payment of these new notes were to be paid in cash realized from the sale of these notes. A syndicate of Jay Gould, Russell Sage, Sidney Dillon, F. L. Ames, and a number of other directors of the Union Pacific agreed to underwrite the series.³ The authorized issue was to be \$24,000,000, but of this amount only about \$18,000,000 were actually issued. As collateral security for the payment of these notes, all the unpledged bonds, stocks, and notes owned by the Union Pacific, these bonds and stocks representing control of the auxiliary lines, were deposited in trust with Drexel, Morgan and Company, as trustees. The par value of the bonds so deposited was \$39,826,566, the par value of the stock was \$56,334,418, and the par value of the company's bills receivable so deposited was \$2,342,481. The market value of the entire lot of securities and notes so deposited was

² Copy of the trust indenture is in the Annual Report of the company for 1891, p. 139.

³ Chron. 53: 187 (1891).

estimated at \$42,105,047.⁴ The trustees were permitted at their discretion to reduce the principal of these notes by selling from time to time portions of the securities which had been so pledged.

This plan relieved the Union Pacific from the immediate pressure of the floating debt. It was expected that as favorable opportunities were presented from time to time a portion of the collateral might be sold advantageously, and it was hoped that a general improvement in business would place the company in a better position to meet whatever notes might remain outstanding at the maturity of the series. For a time it seemed that a general improvement in the company's business would take place. The two years of 1891 and 1892 saw a general increase in tonnage and in gross and net earnings, although the net earnings of the system increased very slowly as compared with the very large increase in business. In the year 1892 both gross and net earnings reached the highest point they had ever attained in the company's history; yet the fixed charges upon the 8,000 miles of the system left but a small relative surplus applicable to dividends.⁵ The earnings of the first half of the year 1893 showed a falling off; but the decrease was not alarming. Late in the spring of the year 1893 the *Commercial and Financial Chronicle* observed that "the affairs of this great property are hence on the whole in a pretty satisfactory condition."⁶ Between 1891 and 1893 about \$7,000,000 were realized from the sale of some of the securities against which the collateral trust notes of 1891 had been issued, so that the total amount of these notes outstanding was reduced from about \$18,000,000 to \$11,430,000 by the close of the first half of 1893.⁷

An attempt of some foreign interests at the annual election

⁴ Chron. 53: 290 (1891).

⁵ Annual Reports. The net surplus earnings after the payment of all fixed charges upon the entire Union Pacific system amounted to \$2,069,257.04 in 1892.

⁶ Chron. 56: 693 (1893).

⁷ Chron. 57: 181 (1893).

in the spring of 1892 to oust Gould and Sage from the directorate and elect an independent board of directors was unsuccessful.⁸ At this election S. H. H. Clark was elected to fill the office of president, which had again become vacant by the resignation of Sidney Dillon. Before the end of the same year, 1892, Jay Gould died, and his son, George Gould, was elected to succeed him on the board of directors.

The floating debt had been temporarily provided for. The road's earnings were sufficient during the prosperous years of 1891 and 1892 to meet fixed charges, and if the government would grant an extension of time to the company for the payment of its debt under some arrangement which would terminate the existing unsatisfactory relations, a rise in the market values of the company's securities might be reasonably expected. The date of maturity of the subsidy bonds was now near at hand, and the question of settlement could not long be postponed. Other classes of bonds were about to mature, and the chance would soon be offered to refund them at lower rates of interest. When Gould again acquired control of the Union Pacific the stock values were down. It was therefore in Gould's interest so to manage the road as to bring up the market value of the stock. Without question, too, the great system of southwestern roads which Gould controlled⁹ would be benefited by his control of the Union Pacific. But whatever may have been his plans, they were never carried out.

Near Maturity of Subsidy Bonds

The government's second mortgage would mature from time to time between November 1, 1895, and January 1, 1899. On December 14, 1891, Senator Frye, of Maine, introduced a bill in the Senate for the refunding of the Pacific railroad

⁸ Chron., 54: 725 (1892).

⁹ The Missouri Pacific-Iron Mountain system, including the Texas and Pacific and a number of other important lines. The system extended in a general southwesterly direction from St. Louis.

debts for a period of 100 years, with interest at 1 per cent per annum for ten years, commencing in 1892, and at 2 per cent per annum thereafter.¹⁰ This bill was approved by the Commissioner of Railroads, except that the Commissioner recommended that interest at 2 per cent per annum begin at once.¹¹ Under the Commissioner's plan, the entire debt was to be retired at the end of 100 years. The companies were to pay each year, in addition to the annual interest at 2 per cent, a portion of the principal. Payments upon both principal and interest for the first ten years under the plan proposed by the Commissioner would have averaged, in the case of the Union Pacific, \$1,224,259.52 annually for the first ten years, and \$1,349,877.15 for the entire period, or about the same amount which the Union Pacific was at that time annually paying to the government under the provisions of the Thurman Act; only if the proposed plan were adopted, payments would be fixed, instead of contingent upon the road's net earnings. Neither the plan proposed in Senator Frye's bill nor the plan recommended by the Commissioner of Railroads was adopted by Congress.

So long as the Adams administration and the element of the stockholders which Adams represented were in control, the government was dealing with a management in no wise responsible for the situation, and one which was endeavoring to remedy, so far as possible, the unsatisfactory relations between the company and the government. These unsatisfactory relations the acts of past administrations had done much to bring about. What had been done by former managements could not be undone, and the problem was how best to deal with an existing situation. The case was somewhat altered after 1890. The company's continued failure to pay dividends was partly attributable to the government's vacillating policy.

¹⁰ Cong. Record, 52nd Cong., 1st sess., p. 43.

¹¹ Report of the Commissioner of Railroads for 1892, p. 6.

As Adams had predicted,¹² the failure of the road to pay dividends had again resulted in control of the road by speculators. The same group was in control after 1890 which had managed the property from 1873 to 1884, and this group was to a large degree responsible for the existing unsatisfactory condition of affairs.

On the other hand, from a business point of view the situation was unchanged. Extension of time offered what appeared to be the best proposition to the government, especially if a plan of refunding were adopted which would give to the government, instead of the lien upon the main line only, a superior security by way of a lien upon all of the assets of the company, its branches, terminals, and lands. The alternative to refunding was foreclosure. Viewed from a financial standpoint, a foreclosure which would result in government ownership was open to objection. In case of foreclosure it would be necessary for the government either to assume or pay the various prior mortgages upon different portions of the line. These prior mortgages amounted to over \$35,000,000 in the case of the Union Pacific, and to over \$63,000,000 in the case of all the bond-aided roads.¹³ If this should be done, the government would then acquire a single trunk line extending from Omaha to Ogden, and from Ogden to the Pacific Coast, as well as the former Kansas Pacific line from Kansas City west for $393\frac{15}{16}$ miles.¹⁴ The government's lien did not cover any of the branches, nor the line from the 394th mile post on the Kansas Division of the Union Pacific to Cheyenne, nor valuable terminal properties at Omaha, Denver, and Kansas City, nor terminal properties at Oakland, California, belonging to the Central Pacific. It was a disputed question whether the government's lien extended over the Omaha Bridge. Unless the government should invest a large

¹² Adams' remarks before the House Committee on Pacific Railroads, printed in the company's Annual Report for 1885, p. 148.

¹³ Report of the Railroad Commissioner for 1892, p. 15.

¹⁴ As well as the Sioux City and Pacific and 100 miles of the Central Branch Union Pacific.

additional sum in acquiring terminals and feeder lines necessary to the successful operation of the Union Pacific, the portions covered by the government's lien would be of little value if other companies which owned connecting lines and terminals should refuse to make traffic agreements with the government. It was the general belief that for the government to acquire the Pacific railroads would entail heavy outlays, and the attitude of the great bulk of persons who were familiar with the question was expressed by the Commissioner of Railroads when he said, "It is time to get money out of the Pacific railroads, not to put more in."¹⁵

Insolvency of Company; Appointment of Receivers

The company's relations with the United States government continued unchanged for some years after 1891. Leaving this question for a time and turning to the internal history of the company, we find that the first three years of this decade, like the first three years of the previous one, were years of increasing traffic and increasing earnings. Net earnings did not, however, increase in proportion to the very large increase of traffic; for rates declined rapidly each year after 1890. The averaged rates per ton per mile upon the consolidated line and upon the system during the first four years of the decade were:¹⁶

YEAR	CONSOLIDATED LINE	SYSTEM
1890	1.21	1.38
1891	1.13	1.34
1892	1.10	1.31
1893	1.01	1.21

In 1891, although the number of tons carried one mile exceeded the number of tons carried one mile in 1890 by $3\frac{1}{3}$ per cent, freight earnings increased but $\frac{7}{10}$ of 1 per cent.¹⁷ Tonnage increased $3\frac{1}{4}$ per cent the following year, while freight earn-

¹⁵ Report of the Commissioner of Railroads for 1892, p. 20.

¹⁶ Annual Reports.

¹⁷ Annual Report for 1893, p. 19.

ings increased but $1\frac{2}{3}$ per cent. In the same year, 1892, the number of passengers carried one mile increased $2\frac{2}{3}$ per cent, while passenger earnings actually decreased.¹⁸

In the year 1893, earnings declined to such a point that the road became insolvent. The last six months of the year were particularly disastrous. The net earnings of the entire system for 1893 were over \$4,250,000, or over 30 per cent less than the corresponding figures for 1892. The complete demoralization of business which resulted from the nationwide financial panic of 1893 was the direct cause of this decline. The earnings of every railroad in the country suffered. Before the end of the year a large percentage of the railway mileage of the country had been placed in the hands of receivers. So far as the Union Pacific was concerned, crop failures in the region through which the road passed intensified the situation, which became still worse after the repeal of the Sherman Silver Purchase Act closed the United States mints to silver coinage and compelled the Colorado silver mines to suspend operations.

The severity of competition among western railroads had recently been increased by the completion of a new transcontinental line, the Great Northern. The Union Pacific had now three competitors for the overland traffic of the northwest: the Northern Pacific, the Canadian Pacific, and the Great Northern. The company's financial situation was in 1893 complicated by the near approach of the date of maturity of four classes of Union Pacific bonds. The "sinking fund 8 per cents," of which a little over \$5,000,000 remained outstanding, matured in September, 1893. The collateral trust notes of 1891 matured in 1894. The government subsidy debt and the company's first mortgage bonds matured at intervals from 1895 to 1899. The old land grant bonds had been redeemed and canceled,¹⁹ and the sinking fund 8's now

¹⁸ Annual Report for 1893, p. 19.

¹⁹ Except eight bonds of \$1,000 each.

constituted a first mortgage on so much of the land grant as remained unsold. These sinking fund bonds were well secured, and the company was able to make an arrangement in August, 1893, whereby the time for their redemption was extended until 1899.²⁰ As the other classes of bonds matured, however, the changed business conditions would make it difficult for the company to refund them advantageously.

By the fall of 1893 it had become evident that a receivership could no longer be avoided. It was plain from the returns of the first nine months of the year that the year's net earnings would fall far below the net earnings of 1892, and that they would probably be insufficient to meet fixed charges. In October, 1893, three large stockholders of the Union Pacific, Edwin F. Atkins, Peter B. Wyckoff, and the executors of the estate of Frederick L. Ames,²¹ brought proceedings in the United States Circuit Court for the district of Nebraska, wherein the insolvency of the Union Pacific was alleged, and appointment of receivers for the Union Pacific system was asked for.²² The complaint declared that such a course was necessary in order to prevent the dismemberment of the system by foreclosure suits. Said the complaint:

The various mortgages securing the bonds and obligations (of the different portions of the System) will become defaulted and subject to foreclosure proceedings, and the said Union Pacific System will be dismembered, depreciated, and dissipated, to the manifest and irreparable injury to the public and the Government of the United States, and the company's creditors and shareholders.

The complainants asked that the property be taken into judicial custody in order to prevent the system from being dismantled, dissipated and dismembered. The court granted the

²⁰ Copy of the extension is in the company's report for 1893, p. 168.

²¹ Ames died in September, 1893.

²² Copy of the petition for the appointment of receivers is in the Report of the Commissioner of Railroads for 1894; also in the record in the case, *United States v. Union Pacific Railroad Company, et al.*, docket No. 993, Circuit Court of the United States for the district of Utah, Evidence and Proceedings before the Special Examiner, p. 3469. This authority will hereafter be referred to as "Proc. Spec. Ex."

prayer of the complainants, and on October 13, 1893, three receivers were appointed: S. H. H. Clark, the president of the road; Oliver W. Mink, the comptroller, and E. Ellery Anderson, a government director and one of the Commission of three who had investigated the Pacific railways in 1887. A month later, upon a supplementary petition of the Attorney-General of the United States, two additional receivers, John W. Doane, of Chicago, and Frederick R. Coudert, of New York, were appointed; so that the government had three representatives among the five receivers.

Disintegration of System

After the receivers were appointed, the earlier tendency toward expansion stopped. During the receivership, parts of the system from time to time became separated from the parent company, in some cases only temporarily, in other cases permanently. Notwithstanding the fact that the receivership was an avowed attempt to prevent the system from disintegrating, a number of important auxiliary lines were placed in the hands of separate receivers. As early as August, 1893, Ex-Governor Evans, of Colorado, a prominent stockholder in the Union Pacific, Denver and Gulf, petitioned for an accounting, alleging that this line was being "bled" for the benefit of the Union Pacific main line. Upon Governor Evans' petition a separate receiver for the Union Pacific, Denver and Gulf was appointed in December, 1893.²³ This appointment was made in spite of the opposition of the Union Pacific. In October, 1893, the Denver, Leadville and Gunnison line²⁴ was placed in the hands of the same receiver who had been appointed for the Union Pacific, Denver and Gulf. In the following year, 1894, the Denver, Leadville and Gunnison line was permanently separated from the Union Pacific by foreclosure and sale.²⁵ In July, 1894, a separate receiver was appointed for the Oregon

²³ Chron., 57: 980, 1040 (1893).

²⁴ A reorganization of the old Denver, South Park and Pacific.

²⁵ Chron., 59: 291 (1894).

Railway and Navigation Company. Other auxiliary lines also passed out of the control of the Union Pacific receivers, pending foreclosure.

It was the policy of the receivers to check the process of disintegration of the system by paying, so far as the court allowed, the interest upon the various collateral trust obligations, and upon the outstanding bonds of such subsidiary lines as were deemed indispensable to the system, even though the interest on the Union Pacific first mortgage bonds might be in arrears.²⁶ At the same time the receivers directed their efforts toward ridding the Union Pacific of unprofitable branches and burdensome contracts. On July 19, 1894, the receivers presented a petition to the United States Circuit Court in regard to certain non-paying branches of the system, and asked to be relieved from operating such branches, and from carrying out the provisions of contracts made with such branches in regard to the constructive mileage allowed such branches in dividing through rates.²⁷ The court ordered that the Denver, Leadville and Gunnison road be divorced from the Union Pacific system, and that further hearings be had as to the other branches. Testimony in regard to these branches and the extent to which the receivers were bound by traffic contracts with them was taken before a master in chancery appointed by the court, who, in the fall of 1894, recommended that the operation of certain branches be continued, but reported that traffic contracts and contracts relating to interest guaranties made with certain other branches had never been ratified by the receivers, and that the receivers were not bound by them. The master recommended that the receivers be relieved from these contracts and from operating certain branches.²⁸ The court confirmed the master's recommendations in the main, and relieved the Union Pacific receivers from contracts with the

²⁶ Hearings before the Senate Committee on Pacific Railroads, Sen. Docs. No. 314, 54th Cong., 1st sess. (serial No. 3357), pp. 364 ff., testimony of Oliver W. Mink.

²⁷ Chron., 59: 117 (1894).

²⁸ Chron., 59: 740 (1894).

Oregon Railway and Navigation Company, the Omaha and Republican Valley Railway, the St. Joseph and Grand Island Railway, the Union Pacific, Lincoln and Colorado Railway, and some other auxiliary lines.²⁹ Partly as a result of the policy of the receivers to terminate unprofitable arrangements with auxiliary lines, and partly as a result of foreclosure proceedings instituted against different portions of the system, the total mileage of the operated lines of the system was reduced from about 8,000 miles in 1893 to less than 5,000 miles in 1894.³⁰

Proposed Reorganization Plans

In the meantime reorganization committees representing different classes of security-holders came into existence from time to time. The most representative committee appears to have been one appointed in November, 1893, whose members were United States Senator Calvin H. Brice, of the Senate Committee on Pacific Railroads; A. A. H. Boissevain, of Amsterdam, Holland, representing the foreign security-holders; General Louis Fitzgerald, the president of the Mercantile Trust Company, who represented the Gould interests; Samuel Carr, for the estate of Frederick L. Ames; General Granville M. Dodge, for the Union Pacific, Denver and Gulf road's interests; and Colonel H. L. Higginson for the Oregon Railway and Navigation Company.³¹ Reorganization involved the settlement of the company's debt to the government; a readjustment of fixed charges which would bring them within the road's earning capacity; and the disposal of certain problems which related to the system of auxiliary lines.

No proposition for reorganization could well be entertained until mutually satisfactory arrangements relating to the company's debt to the government had been made. Mr. Boissevain

²⁹ Chron., 59: 970.

³⁰ Annual Reports of the company.

³¹ Chron., 57: 894 (1893).

proposed the following tentative plan of general reorganization: that the company deliver to the United States a new issue of 100-year 2 per cent bonds for the entire amount of principal and interest owing to the government, such bonds to be secured by a mortgage upon the property, and by a sinking fund to redeem the entire issue in 100 years; that the securities in the sinking fund established by the Thurman Act be applied toward the redemption of the underlying first mortgage bonds and the balance of the first mortgage bonds, about \$20,000,000, be extended and renewed at a rate of interest not to exceed 5 per cent per annum, a sinking fund being provided for their redemption; that certain new securities be issued. Mr. Boissevain said:

The fixed charges of the reorganized company under the new plan should not exceed \$8,500,000 per annum. Certain classes of existing bonds secured by mortgage on portions of the system cannot be and should not be disturbed, as they are amply secured by property earning the interest which is payable thereon. Other bonds, however, must be converted in whole or in part into securities not imposing a fixed charge upon the reorganized company. While the reorganization committee has not approved of any definite plan, we believe that holders of bonds which must be disturbed and creditors and stockholders interested in the system can be provided for upon an equitable basis by the creation of the following new securities:

(a) An issue of general mortgage bonds bearing interest at the rate of four per cent per annum, secured by a general mortgage covering the entire system, subject to such mortgages as cannot be disturbed and to the lien of the United States, upon the main line and Kansas Division for the adjusted debt.

(b) An issue of five per cent preferred stock.

(c) An issue of common stock.

The plan of reorganization would require provision to be made to take up the trust notes secured by valuable collaterals. The funds required for this purpose and for the other cash requirements of the reorganization would be met in part by a

reasonable assessment upon the stockholders and in part by the sale of new securities.³²

The government directors proposed a plan of reorganization, the main features of which were:

1. That the entire road be subjected to a single mortgage, under which 3 per cent 100-year bonds should be issued to an amount such that the accruing interest would not exceed the minimum earning power of the road.
2. That the money or securities in the Thurman Act sinking fund be applied to the payment or extinction of bonds having a priority of lien over the lien of the government.
3. That the common stock be assessed \$10 a share, and that \$5,000,000 of the amount so raised be applied to the further extinction of bonds having priority of lien over the lien of the Government
4. That so many of the new 3 per cent 100-year bonds be sold as should be required to pay off the remainder of the existing prior lien bonds at maturity.
5. That there be issued to the government an amount of first mortgage 3 per cent 100-year bonds equal to the amount of the road's debt to the government.
6. That the remaining 3 per cent first mortgage bonds and so much preferred stock as necessary be used to compensate security-holders for the reduction of interest on liens subsequent to the lien of the government, and on bonds held in the collateral trusts of the company.
7. That the entire property of the Union Pacific Railway Company, including bonds and lands held in the collateral trusts, be sold under foreclosure.³³

In the spring of 1894 the Attorney-General, Richard Olney, sent to the Speaker of the House of Representatives a draft of a bill entitled "An Act to reorganize the Union Pacific

³² Chron., 58: 988 (1894).

³³ Report of the Government Directors for 1894.

Railway Company, and to Readjust and Secure the Claims of the United States against the said company." The purpose of this proposed bill was to preserve the existing corporation, to relieve it of existing embarrassments, and "to put it in a sound financial and business condition." The bill provided:

1. That the existing first mortgage bonds for \$33,539,512, less the amount of bonds in the sinking fund to be canceled (\$7,616,000), be renewed and extended at a lower rate of interest, not exceeding 5 per cent, with a provision for a sinking fund estimated as sufficient to extinguish the debt at the maturity of the bonds.
2. That the debt of the United States, amounting to about \$70,000,000, be paid in 2 per cent 100-year bonds, secured by a second mortgage on all the present and subsequently acquired property of the company, and further secured by a sinking fund of such amount that the annual payment on account of it and of the interest on these bonds should always be equal to the sum of \$1,650,000.
3. That there be issued bonds secured by a third mortgage of the entire property of the company, called the general mortgage, which should be used in funding and refunding outstanding obligations of the company, and for betterment purposes.

According to the Attorney-General, the proposed bill, if enacted into law, would furnish the groundwork upon which any reorganization plan must rest; would put creditors and stockholders in possession of the actual conditions with which they would have to deal; and would enable them to devise and agree among themselves upon such a plan of reorganization as the equities of the various parties concerned might demand and the property and resources of the company permit.³⁴ Congress, however, took no action on this proposed bill.

The United States Commissioner of Railroads, disregarding the lessons of the past and the opinions expressed by his

³⁴ Chron., 58: 775 (1894).

predecessors in office, recommended that Congress pass a bill which would require the Union Pacific to pay into the United States Treasury 50 per cent of its net earnings each year, until the debt to the government should be automatically discharged.³⁵

The railway company made the following proposition:

1. That the stockholders be assessed a sum sufficient to pay all bonds having a priority of lien over the lien of the United States.
2. That the government refund the subsidy debt at 2 per cent, the government to receive new first mortgage bonds payable in 50 years, secured by a first mortgage upon the 1,822.59 miles of the Union Pacific Railway and further secured by reasonable sinking fund provisions.
3. That power be granted to the reorganization committee to form a successor corporation for the same general purposes and with the same general powers stated in the acts of 1862 and 1864.
4. That the exceptional restrictions on usual corporate powers and rights be removed, and that the successor corporation be given the same rights, privileges and freedom of action that were exercised and enjoyed by other railroads.³⁶

The Proposed Reilly Bill

Various suggestions like the above were offered in Congress in the form of bills. On July 21, 1894, the House Committee on Pacific Railroads, of which Representative Reilly of Pennsylvania was chairman, favorably reported a refunding bill to the House.³⁷ This bill was offered as a substitute for several bills which related to the same subject, and had already

³⁵ Report of the Commissioner of Railroads for 1895, p. 12.

³⁶ Chron., 60: 132 (1895). These suggestions for reorganization (Boissevain's, the Government Directors', Attorney-General Olney's, the Railroad Commissioner's, and the railway's) while they formed the basis of discussion, were neither acted upon nor adopted. They are set forth above in order to illustrate the various lines of thought, and the different attitudes taken by those immediately concerned in the solution of the problem.

³⁷ Cong. Record, 53rd Cong., 2nd sess., p. 9177; House Report No. 1290 (serial No. 3272).

been introduced and referred. Under the plan proposed by the Reilly bill, the amounts then in the sinking fund were to be applied to the payment of the first mortgage, and the company was to make provision for retiring the balance of the first mortgage, by assessment if necessary. The subsidy debt was to be refunded in a 50-year 3 per cent new first mortgage. The company was not only to meet the annual interest on this new first mortgage as it accrued, but was also to pay to the government each year a portion of the principal. Payments on account of the principal were, however, to be graduated, so that the annual payment on account of the principal was to be at the rate of $\frac{1}{2}$ of 1 per cent per annum during the first ten years, and increased gradually with each succeeding ten years. The lien of the government was definitely defined, and was extended to cover terminal properties worth, it was estimated, between \$15,000,000 and \$20,000,000.

A minority of the Pacific Railroad Committee reported against refunding the debt and in favor of foreclosure and sale. One member of the minority, Representative W. A. Harris of Virginia, recommended in an individual report that, as it was the duty of the State to provide its citizens with highways, the United States government should proceed to acquire by foreclosure proceedings the main line of the Union Pacific and Central Pacific. Such course would, Harris declared, teach such a salutary lesson that the other railways of the country would no longer be managed without regard to the rights and interests of the United States government, and the people of the nation. In his report, Harris said of the Pacific Railroads:

Their breach of faith is unparalleled and undenied, and their sole excuse is that they did only that which other companies did, and followed the common custom of railway builders and managers. Why again enter into such an entangling alliance, and permit or risk the sacrifice of public duty and functions to private avarice, greed and bad faith?

I believe that the foreclosure of the Government lien should

at once follow default in payment, and that a complete trans-continental line should be acquired and operated by the only competent and legitimate power, the people, through their Government.³⁸

Harris' report was in accord with the state of opinion in the region through which the Union Pacific passed. The Populist movement of the nineties, which was especially strong in Nebraska, Kansas, and Colorado, was inclined to favor the plan outlined by Harris. Populists were not the only persons who favored the Harris plan; as early as 1887, before the Populist agitation became general throughout the west, the testimony taken by the Pacific Railway Commission revealed the fact that there was a large local element which was thoroughly dissatisfied with the existing situation, and that this element would welcome any plan having for its object the government ownership and operation of the Pacific railroads. This feeling was, however, almost entirely local. Outside of the so-called "Populist West," the proposition for the government acquisition of these roads had but little support.

Congress took no action on the matter during this session, that is, the session of 1893-1894. When the short session of Congress met in December, 1894, the Reilly bill received much discussion, which resulted finally in the second reference of the bill to the Committee on Pacific Railroads. On the 23rd of February, 1895, not much more than a week before the close of the session, a majority of the Pacific Railroad Committee reported a new bill, in which it was proposed that the sums in the sinking fund be applied toward the principal of the subsidy debt; that the company, by stock assessments if necessary, raise a sum sufficient to retire the balance of the principal of the subsidy debt; that the first mortgage bonds be refunded at 4 per cent; and that the interest accumulations due the government be funded in a 50-year 2 per cent second mortgage bond.³⁹ A proposition made by

³⁸ House Report No. 1290, Pt. 2, 53rd Cong., 2nd sess. (serial No. 3272), p. 8.

³⁹ Cong. Record, 53rd Cong., 3rd sess., p. 2642; House Report No. 1924.

the Union Pacific reorganization committee to pay the principal of the subsidy debt in full settlement of the government's claims accompanied this bill, and was reported without recommendation by the Pacific Railroad Committee.⁴⁰ The near approach of the end of the session prevented further consideration of the Pacific railroad question, and the amended Reilly bill, like its predecessor, never came to a vote.

The reorganization committee felt it could proceed no further until the question of readjusting the subsidy debt was settled. When Congress failed to pass the Reilly bill, the reorganization committee disbanded, in March, 1895, and no further progress was made until the following fall.

Operation of Road by Receivers

The receivers had meanwhile been operating so much of the system as remained within their control. The collateral trust notes of 1891 matured in 1894, but they were well secured, and, upon the advice of the trustees, holders of these notes did not press their collection, pending the adoption of some plan of reorganization of the entire system.⁴¹ For a time the Union Pacific receivers paid the interest upon these, and the company's various other collateral trust obligations, in order that the sale of the stocks and bonds by which these obligations were secured might be prevented; but in the fall of 1894 the receivers discontinued paying this interest.⁴² A large part of the auxiliary line system, the stock and bonds of which had been pledged as security for these collateral trust obligations, was now operated by separate receivers.⁴³ The outstanding collateral trust notes of 1891 had been re-

⁴⁰ Chron., 60: 303 (1895).

⁴¹ *Ibid.*, 60: 154 (1895).

⁴² Senate hearings, p. 367, testimony of Oliver W. Mink.

⁴³ The company's collateral trust obligations outstanding on June 30, 1894, were as follows:

Year of Issue	Principal Outstanding	Interest
1879	\$ 3,672,000	6%
1883	4,677,000	5
1889	2,030,000	4½
1891	10,797,000	6

See Sen. Docs. No. 62, 54th Cong., 2nd sess. (serial No. 3469), entitled "Indebtedness and liabilities of the Union Pacific Railway Company."

duced to about \$10,000,000, and the income from the stocks and bonds pledged was sufficient to meet the semiannual interest upon them. As each six months elapsed, interest on these notes was paid by the trustees out of the income from the pledged collaterals.

Interest upon the company's first mortgage bonds was paid as rapidly as the road's earnings warranted. The court, under whose direction the road was operated, refused to authorize the payment of this interest until a sufficient sum had been provided each half-year to meet necessary repairs and renewals. Interest upon the first mortgage was generally several months in default; but there was no question of the security, and the bonds were quoted in the neighborhood of par during the receivership. There were no receiver's certificates issued.

The situation with regard to the Kansas Division was somewhat complicated. The first 394 miles were covered by two divisional first mortgages: the "Eastern Division" mortgage covered the first 140 miles west from Kansas City, while the "Middle Division" mortgage extended over the line from the 140th mile post to the 394th mile post. The line from the 394th mile post to Denver was covered by the "Denver Extension" mortgage, and the line from Denver to Cheyenne was covered by the old Denver Pacific first mortgage. The government's second mortgage covered the first 394 miles west from Kansas City; and in addition, the consolidated mortgage of 1879 covered the entire line from Kansas City to Denver, subject to the above-named first mortgages, and to the government's second mortgage. This complicated situation resulted in a variety of foreclosure suits under the different mortgages, and for a considerable period no interest was paid upon the Kansas Pacific bonds, pending the judicial settlement of the various questions involved in the conflicting interests of the different lien-holders.⁴⁴

⁴⁴ Senate hearings, p. 370, testimony of Oliver W. Mink.

At the close of 1894 the system operated by the Union Pacific receivers still included the consolidated lines of the Union Pacific Railway, the consolidated lines of the Oregon Short Line and Utah Northern Railway, and a number of short branches, amounting in all to about 4,900 miles. The Union Pacific, Denver and Gulf lines, and the Oregon Railway and Navigation Company were operated by separate receivers.⁴⁵ Later on foreclosure proceedings separated the Oregon Short Line and Utah Northern Railway from the Union Pacific system. In the spring of 1895, at the instance of one class of bondholders, a separate receiver was named for the Oregon Short Line and Utah Northern Railway; but it seems that a dispute between two classes of bondholders delayed for a short time the separation of this property from the Union Pacific system.⁴⁶ The Union Pacific receivers continued to operate the Oregon Short Line and Utah Northern for some weeks, but a separate receivership resulted finally. Early in 1897 the Oregon Short Line and Utah Northern Railway was sold under foreclosure, and reorganized independently as the Oregon Short Line Railroad Company.⁴⁷

New Reorganization Plan

In the fall of 1895 a new Union Pacific reorganization committee came into existence. The members of this committee, which represented the first mortgage bondholders, were General Louis Fitzgerald, Jacob Schiff of Kuhn, Loeb and Company, T. Jefferson Coolidge, Jr., the president of the Old Colony Trust Company, Chauncey M. Depew, the president of the New York Central road, Marvin Hughitt, the president of the Northwestern lines, and Oliver Ames, 2nd, a director of the Union Pacific.⁴⁸ The personnel of this committee gave rise to the rumor that the Union Pacific, when it should be reorganized, would be controlled as a part of the

⁴⁵ Chron., 60: 925 (1895).

⁴⁶ *Ibid.*, 60: 968 (1895).

⁴⁷ *Ibid.*, 60: 241 (1895).

⁴⁸ *Ibid.*, 61: 663 (1895).

Vanderbilt group of lines. A plan of reorganization was formulated, which was announced in the fall of 1895.

This plan, with some modifications, was finally adopted. The Union Pacific Railway only was considered. Referring to the auxiliary lines, the circular outlining the plan said:

Considerations will not exist under reorganization for continued relations with these properties upon the basis of any assumption of any of their fixed charges. Geographical conditions and considerations of mutual advantage point to a continued operation of such of these auxiliary properties as have a demonstrated value in harmony with the reorganized company, and relief from the burden of these guaranties will, it is believed, be an advantage obtained without detriment to the property.

This plan therefore contained no express provision relating to the branches, or to the collateral trust obligations of the Union Pacific.

A foreclosure sale and the organization of a new company was contemplated. The capitalization of the reorganized company was to consist of three classes of securities:

First mortgage bonds bearing interest at 4%.....	\$100,000,000
4% non-cumulative preferred stock.....	75,000,000
Common stock.....	61,000,000

Holders of the first mortgage bonds of the Union Pacific Railroad, holders of the sinking fund land grant mortgage bonds, holders of the Omaha Bridge bonds, and holders of the Kansas Pacific first mortgage bonds were to be permitted to exchange their bonds at par for the new 4 per cent first mortgage bonds, and were to receive in addition, in new preferred stock, 50 per cent of the par value of the amount surrendered. The Kansas Pacific consolidated mortgage bonds and other Kansas Division bonds⁴⁹ were to be exchanged for the new bonds at 80 per cent of their par value, and were to receive in addition 50 per cent in preferred stock. The common stock of the railway

⁴⁹ There were still outstanding small amounts of the old Kansas Pacific bonds of issues which had been funded into the consolidated mortgage of 1879.

company was to be exchanged, dollar for dollar, for new common stock, upon the payment of an assessment of \$15 a share. For this assessment new preferred stock was to be issued at par. A syndicate of bankers, headed by Kuhn, Loeb and Company, agreed to advance a sum not exceeding \$15,000,000, to meet coupons as they fell due, and other cash requirements of the reorganization. These bankers were to receive as a commission, \$6,000,000 in preferred stock. There would then remain, according to the figures of the reorganization committee, a balance "reserved for settlement of the debt to the United States and for extraordinary requirements" amounting to \$35,755,280 in new bonds, \$20,864,400 in new preferred stock, and \$131,500 in common stock.⁵⁰ Coupons of the first mortgage bonds were to be paid in full until the first mortgage bonds matured.⁵¹

Security-holders were directed to signify their assent to the plan by depositing their bonds with the committee by the 1st of January, 1896.⁵² The plan was on the whole a good one, and, as later events proved, it was successful. Although the face value of the company's capitalization was to be somewhat larger than it had been before, stock issues upon which dividends were optional were substituted for bond issues upon which the interest was fixed. Interest upon the proposed issue of 4 per cent bonds would amount to but \$4,000,000 annually. This sum appeared to be well within the earning capacity of the road, even in the worst periods of depression. The net earnings of the railway company in 1894 had been the lowest they had ever been for over twenty years; yet in that year they amounted to \$4,315,077.25, or over \$300,000 in excess of the interest on the proposed first mortgage bonds. The company's net earnings for the ten years from 1885 to 1895 had averaged \$7,563,669.10 annually, so that there was a very fair prospect

⁵⁰ The capital stock of the Union Pacific Railway Company was \$60,868,500, par value.

⁵¹ It should be borne in mind that the first mortgage bonds matured from time to time between 1895 to 1899. For copy of the plan of reorganization see Chron., 61: 705 (1895).

⁵² This time limit was later extended to January 29.

that when business conditions should improve there might be a considerable surplus to divide among the preferred stockholders, and possibly leave something for the common stockholders. From the standpoint of the security-holder the plan was excellent. The bondholders would receive in new securities about as much as they surrendered, and whatever reduction of interest they suffered would be offset by the prospect of dividends on the preferred stock when such dividends should be earned, and by the increased security of the new first mortgage. The stockholder alone suffered, and he was partially compensated by receiving preferred stock in exchange for his assessment, as well as new common stock in exchange for his old stock.

Negotiations Over Subsidy Debt

Nearly all of the security-holders had signified their assent to the plan early in 1896, and the only obstacle to reorganization was whatever difficulty would be found in disposing of the road's debt to the government. In March, 1896, the reorganization committee, through its counsel, Winslow L. Pierce, submitted its plan to the Senate Committee on Pacific railroads, with a view to securing the passage of an act which should dispose in some way of the question of the subsidy debt, and so permit the plan to go into effect. While the plan made no definite provision for this debt, over \$56,000,000 in new securities had been set apart for this purpose. These securities could not, however, be considered as so much cash. Moreover, since under the plan the preferred stock would control the road,⁵³ complications might arise should the government accept preferred stock in payment of a portion of the debt, and thus become a stockholder of a great railroad company.

The Committee on Pacific Railroads held a number of hearings in the spring of 1896, at which several of the men

⁵³ Senate hearings, p. 9, testimony of Winslow Pierce. Both classes of stock, preferred and common, were to have the right to vote.

connected in one way or another with the Union Pacific and Central Pacific Railways were examined. These men advanced the argument that the government should do as any other bondholder would do under like circumstances, and participate in the reorganization, even though participation might necessitate certain concessions on its part. Various propositions for refunding, or for cash payment of a portion of the debt if the government would execute a release of the balance, were suggested by representatives of the reorganization committee of the Union Pacific, and by the receivers of the railway. All of the suggestions for immediate cash settlement contemplated a partial money loss to the government, and the only apparent alternatives were either refunding the debt, or foreclosure. The result of these hearings was that on April 21, 1896, a majority of the Pacific Railroad Committee reported a bill to refund the debt at a lower rate of interest.⁵⁴ One member of the committee, however, Senator Morgan of Kansas, reported in favor of foreclosure and the acquisition of the Union Pacific and Central Pacific by the United States.⁵⁵

No further progress either one way or the other was made during the remainder of the year 1896. Finally, after months of debate, on January 11, 1897, a proposed refunding bill similar to that reported in the Senate the previous year was definitely rejected in the House of Representatives.⁵⁶ President Cleveland now gave directions to the Attorney-General, Judson Harmon, to take whatever steps might be necessary for the protection of the government's lien.⁵⁷ It became evident that the government would insist upon cash settlement. The reorganization committee gave up its efforts to obtain an extension of time, and prepared to meet a cash settlement upon as favorable terms as the government would be willing to concede. Negotiations commenced between the Attorney-General and

⁵⁴ Sen. Report No. 778, 54th Cong., 1st sess., Pt. 1.

⁵⁵ *Ibid.*, Pt. 2.

⁵⁶ Cong. Record, 54th Cong., 2nd sess., p. 688.

⁵⁷ Sen. Doc. No. 83, 54th Cong., 2nd sess. (serial No. 3469), contains the correspondence.

the reorganization committee, with the result that an agreement was reached that the Union Pacific Railway should be sold under foreclosure to the proposed new company, the reorganization committee to guarantee a minimum cash bid of \$45,754,059.99, in addition to assuming the first mortgage.⁵⁸ The value of the sinking fund investments reduced this amount by about \$17,000,000. Had this arrangement been carried out, the government would have received in cash the entire principal of the debt, and simple interest at the rate of about 3½ per cent per annum from the date of issue of the bonds to their maturity. The syndicate of bankers headed by Kuhn, Loeb and Company agreed to furnish this large sum, and in exchange were to receive 100 per cent in new first mortgage bonds and 50 per cent in new preferred stock for their advances.

This conclusion was reached early in 1897. Foreclosure proceedings now went ahead rapidly. The foreclosure decrees were, however, not altogether satisfactory to the government, by reason of the fact that the Omaha Bridge mortgage, amounting to over \$1,200,000, was declared to constitute a lien prior to that of the government on that portion of the road between Council Bluffs and Omaha, and by reason of the fact that the money and assets in the hands of the receivers accruing from the operation of the roads were ordered sold, instead of being reserved to meet a deficiency judgment expected to be obtained by the government. The government thereupon prepared papers for an appeal. The reorganization committee was anxious to avoid further delay, and offered to increase its guarantee to \$50,000,000, provided the government would withdraw its appeal and allow the foreclosure suit to be brought to an immediate end.⁵⁹

To this the government agreed, and the sale was now ordered to take place at Omaha on the 1st of November, 1897.

⁵⁸ Senate Doc. No. 83, 54th Cong., 2nd sess. (serial No. 3469).

⁵⁹ Report of the Commissioner of Railroads for 1897, p. 7.

The plan of reorganization was modified in some respects, a change being made in the allotment of new bonds and stock to be given in exchange for Kansas Pacific consolidated mortgage bonds and the sinking fund land grant 8 per cents. The former were to receive 50 per cent in new bonds and 110 per cent in new preferred stock, instead of 80 per cent in bonds and 50 per cent in preferred stock. The latter were to receive 75 per cent in new bonds and 100 per cent in new preferred stock, instead of 100 per cent in new bonds and 50 per cent in preferred stock.⁶⁰ The various collateral trust bonds and notes were independently provided for by the collateral underlying them. The sale of securities against which the collateral trust notes of 1891 had been issued had materially reduced the amount of these notes outstanding, and the balance of these notes were eventually retired by the sale of a further portion of the pledged securities. The bonds and stock of the Union Pacific, Denver and Gulf road, which had formed a part of these pledged securities, were sold to the reorganization committee of the Union Pacific, Denver and Gulf.⁶¹ This road was independently reorganized as the Colorado and Southern, and did not again become a part of the Union Pacific system. Other branch line securities were sold to the Union Pacific reorganization committee.

Foreclosure and Sale

It appeared in the early fall of 1897 that the reorganization would meet with no further obstacles, and that within a few months the reorganized company would be operating the Union Pacific. Suddenly, on the 25th of October, 1897, the Attorney-General notified the reorganization committee that the government had applied for a postponement of the sale until December 15, after Congress could meet and consider the question.⁶² This was most unwelcome news to the reorganization com-

⁶⁰ Chron., 65: 235 (1897); 65: 288 (1897).

⁶¹ *Ibid.*, 66: 516 (1897).

⁶² *Ibid.*, 66: 825 (1897).

mittee. Further congressional agitation might jeopardize the whole plan of reorganization. The committee decided to increase its minimum guaranteed bid still further. The former bid had included both the Union Pacific and the Kansas Pacific. The committee now offered to guarantee the full amount, in cash, of the principal and interest of the bonds issued to the Union Pacific Railroad. The company had already repaid a portion of the interest on these bonds through transportation and through the payment of 5 per cent of its annual net earnings. The balance due the government was about \$58,000,000. The committee's bid did not include the Kansas Pacific. The sale of the Kansas Pacific was accordingly postponed until the 15th of December. The increased bid for the main line was accepted, and the government interposed no further obstacles to the sale of the Union Pacific. The main line was sold under foreclosure on November 1, 1897, for \$58,448,223.75, subject to the first mortgage.⁶³ Title to the property, franchise, and lands of the old Union Pacific Railway now became vested in a new corporation, the Union Pacific Railroad Company, organized in the summer of 1897 under the laws of the state of Utah.⁶⁴

The *Commercial and Financial Chronicle* made the following estimate of the cost of the road:⁶⁵

Government's claim.....	\$58,448,223.75
Less sinking fund.....	18,194,618.26
<hr/>	
Second lien.....	\$40,253,605.49
First mortgage.....	27,637,435.00
Securities purchased.....	13,645,250.00
<hr/>	
Total cost of road to reorganization committee...	\$81,536,290.49

The sale of the Kansas Pacific, which was postponed to December 15, was again postponed. The government and the

⁶³ Chron., 65: 870 (1897).

⁶⁴ Copy of Articles of Association of the Union Pacific Railroad Company is in Proc. Spec. Ex., p. 3423.

⁶⁵ Chron., 66: 52 (1898).

reorganization committee experienced some difficulty in reaching an agreement regarding the minimum amount which the committee was to guarantee. After about a month and a half of negotiation, it was finally arranged that the committee was to guarantee to pay in cash the principal only of the subsidy debt, \$6,303,000.⁶⁶ On February 16, 1898, the subsidized portion of the line was sold under foreclosure of the government's mortgage to the Union Pacific reorganization committee, and in the next few days, as a result of foreclosure sales under the other mortgages, the title to the entire property of the Kansas Pacific, including right of way, land grant, and terminals, was transferred to the new corporation, the Union Pacific Railroad Company.⁶⁷ The reorganized company took possession of the main line from Council Bluffs to Ogden on January 31, 1898, and of the Kansas Division on April 1, 1898, and the receivers were discharged.

So far as the main line was concerned, the government received full satisfaction for its mortgage. A year and a half before, such a result had seemed extremely doubtful. It had been generally supposed that a foreclosure sale would not yield anything like the sum necessary to pay the government's second mortgage and the large interest accumulations upon it. At one stage of the proceedings it had appeared possible that the first mortgage bondholders might foreclose the government out of its lien. This was even threatened in an effort to secure more favorable terms. During the hearings before the Senate Committee on Pacific Railroads, in March, 1896, Winslow Pierce put forward the proposition that if the government did not make satisfactory concessions, the first mortgage bondholders might foreclose without regard to the government, in which case the government would probably lose the greater part, if not all, of its debt.⁶⁸ A financial journal commented upon the fact that as the reorganization committee represented

⁶⁶ Chron., 66: 385 (1898).

⁶⁷ *Ibid.*

⁶⁸ See Senate hearings.

the first mortgage bondholders, it was in their power to bring the government to terms.⁶⁹ Mr. Pierce assured the members of the Pacific Railroad Committee of the Senate that the object of his clients in taking into consideration the rights of the government was with a view to reaching an amicable settlement of the subsidy debt. He declared that it was the wish of the reorganization committee to do the fair thing by the government, by according to the government in the reorganization the same consideration that an ordinary second lien-holder would receive under the same circumstances.

It is, however, hard to accept at its full face value this statement regarding the magnanimous intentions of the reorganization committee. A first mortgagee does not ordinarily make important concessions to a second mortgagee unless he has good reasons for so doing. If the reorganization committee had the unquestioned power, as they claimed, to foreclose the government out of its lien, it is hard to believe that they would not have done so. The syndicate headed by Kuhn, Loeb and Company did indeed receive in new bonds and stock more than the equivalent of the cash they advanced to pay off the debt to the government. Yet the sum would in all probability not have been forthcoming had there been any way of completing the reorganization without meeting the government's demand. The cash payments to the government necessitated the issue of a larger amount of new securities than had originally been intended, although the authorized amount of new bonds and stock was not increased beyond the amounts provided for in the plan of reorganization, that is to say, \$100,000,000 of new first mortgage bonds, \$75,000,000 of new preferred stock, and \$61,000,000 of new common stock.

The probability is that the first mortgage bondholders did not dare to foreclose the government out of its lien. Considerations of political expediency, which may be and often are as strong as legal rights, caused them to hesitate. This

⁶⁹ Chron., 61: 683 (1895).

period of the nineties was the period of the Populist agitation in the states of the west. Even in sections of the country where Populism found little favor, the Credit Mobilier "scandal" had not by any means been forgotten. Many men who were not in sympathy with the Populists, and who were not in favor of government ownership, or even of government regulation of railroads on a large scale, believed that the Union Pacific Railway, or the men who had controlled that company, had been guilty of great frauds upon the United States government. About two-thirds of the original cost of the road had been met out of the proceeds of government grants. Any proceeding whereby a group of capitalists or a syndicate should acquire the property by a foreclosure sale which would result in a loss to the government of the greater part of its debt might, in view of public sentiment toward railroad companies, have raised a tremendous national outcry, greater and more far reaching in its effects than even the clamor which arose earlier, at the time of the Credit Mobilier episode. Congress was not disposed to be friendly to the Pacific railways. The fifty-fourth Congress had voted down a refunding bill, and it was altogether possible that drastic affirmative action would be taken, should the reorganization committee refuse to yield.

It seems, moreover, that there was some question as to whether the first mortgage bondholders could have legally enforced their claim as a lien paramount to the lien of the government.⁷⁰ Whether or not these bondholders believed that in the end they would have been sustained had they attempted to enforce their claim, they determined at any rate not to try conclusions with the government. The fact that they did completely yield so far as the main line was concerned is a virtual admission that they feared the legal or equitable rights of the government, or the business or political complications that might arise in case they attempted to enforce their claim.

With the sale of the Union Pacific property and the pay-

⁷⁰ See Senate hearings, pp. 368 ff.

ment of the government's claim, the special relations between the government and the Union Pacific Railway Company came to an end. On the whole the settlement was, from a financial standpoint, a favorable one for the government, although it cannot be said that it was unfair to the company. The entire subsidy debt, principal and interest, of the original Union Pacific Railroad was paid in full, and the principal of the debt of the Kansas Pacific was paid,⁷¹ so that the government received about \$64,000,000 in settlement of its claim for about \$70,000,000. This amount greatly exceeded the maximum sum which the most sanguine persons had at one time expected in case the government were to insist upon cash payment.

The general plan for the exchange of old securities for new securities was as follows:

AMOUNTS SURRENDERED	TO RECEIVE IN NEW SECURITIES		
	1st Mortgage 4% Bonds	Preferred Stock	Common Stock
Union Pacific:			
1st mortgage bonds, \$1,000.....	\$1,000	\$500	
Sinking fund 8's, \$1,000.....	750	1,000	
Omaha Bridge 8's, 1,000.....		cash	
Omaha Bridge renewal 5's, \$1,000.....	1,000	250	
Kansas Pacific:			
Divisional 1st mortgage bonds, \$1,000...	1,000	500	
Consolidated mortgage bonds, \$1,000.....	500	1,100	
Fragments of old loans, \$1,000.....	800	500	
Union Pacific stock, \$100, upon payment of assessment.....		15	\$100

⁷¹ The government's claim against the Kansas Pacific amounted to \$12,891,900. The government subsequently brought suit for the balance, but recovered only \$891,898.

CHAPTER XI

THE GROWTH OF THE UNION PACIFIC FROM TIME OF THE REORGANIZATION DOWN TO 1905

The New Management; E. H. Harriman

The plan of reorganization by which preferred stock was issued to the bondholders and to the financial syndicate which had managed the reorganization removed the Union Pacific from the Gould control; but as George Gould received a large amount of new stock in exchange for his holdings in the old company, he was elected a member of the board of directors of the new company, and served as director for several years after the reorganization. Among the other directors of the new company were Otto H. Kahn and Jacob Schiff of Kuhn, Loeb and Company, the bankers who had financed the reorganization; Marvin Hughitt of the Chicago and Northwestern road; Roswell Miller of the Chicago, Milwaukee and St. Paul; and Oliver Ames, the son of Frederick L. Ames and grandson of the Oliver Ames who had been president of the original company when the road was first built. Horace G. Burt, the third vice-president of the Northwestern lines, was chosen president of the new company.

Whether or not there was any foundation in the earlier rumor that the Union Pacific was to become an adjunct of the Vanderbilt system, no such thing occurred. It is true that the Vanderbilt interests were now not without representation upon the Union Pacific board. Yet a new and hitherto comparatively unknown man was soon to dominate the Union Pacific, and through his mastery of the Union Pacific extend his power over other lines until he became the most conspicuous railroad magnate of America, if not of the world. This was E. H.

Harriman. In 1870, Harriman had come from Hempstead, Long Island, to New York, where he began his career as a clerk in a broker's office. He was alert, watched his opportunities, and aided by a series of fortunate speculations, managed during the course of the next twenty years to accumulate a very considerable fortune. Railroads seemed to have attracted his interest, and he became a sharp student and a keen observer of their problems and of the details of their operation. He became connected with a number of railroads, notably the Illinois Central, but it was through the Union Pacific that he attained his later prominence. Harriman, it seems, was the "railroad man" of the financial syndicate which had charge of reorganizing the Union Pacific.¹ He became a director of the new company and chairman of the executive committee of the board. From time to time he increased his holdings of Union Pacific stock by making large purchases of the common shares, which, in 1898, were quoted in the neighborhood of 25.² Within a surprisingly short time his influence dominated the management, and by 1900 his control of the Union Pacific had become absolute.³

The history of the reorganized company is in striking contrast to that of its predecessor. The old Union Pacific had often been contemptuously referred to as "two rusty streaks of iron on an old road-bed."⁴ Financially it could not be classed as a strong road. On the other hand, the new company has become one of the strongest and most powerful railroads in the United States. During the decade following the reorganization, its history was marked by rapid growth and

¹ Proc. Spec. Ex., p. 4729, testimony of Otto H. Kahn. Yet Kahn elsewhere says that Harriman had nothing to do with the reorganization, but that he was admitted to the board of the new company in pursuance of some promise made to him by Kuhn, Loeb and Company. See E. H. Harriman, by Otto H. Kahn, the Railway Library, compiled by Slason Thompson, Vol. II, p. 313. (Chicago, 1911.)

² Files of the Commercial and Financial Chronicle.

³ 12 I. C. C. Rep. 319.

⁴ This phrase was first used by Charles Francis Adams in some remarks which he had at one time made at a congressional hearing, to characterize the sort of road which would result if Congress persisted in harassing the company by ill-considered attacks. These attacks, Adams maintained, were made in the interests of speculators, who were seeking control of the road. They would, said Adams, loot the road if they could and then abandon to the government "two rusty streaks of iron on an old road-bed."

expansion on a much greater scale than had been the case in the expansion period of the eighties. Under the control of Harriman, the mileage of the Union Pacific grew from less than 2,000 miles in 1898 to over 6,000 miles in 1909. In addition the company acquired control of the 7,000 miles embraced in the Southern Pacific system. Steamship lines as well as railroads were included. By 1908 Harriman, through his high position in the councils of the Union Pacific, had become the most prominent as well as the most powerful single individual in the railroad world, so that one author wrote in 1909:

In comparison with him, the Vanderbilts, the Goulds, the Garretts, the Huntingtons represent the parochial period in our railroad history. They consolidated small railroads into kingdoms, Harriman is federating their kingdoms into empires.⁵

Reacquisition of Branch Lines

The first step in this direction was the reacquisition by the Union Pacific of the important auxiliary lines which had formerly made up the Union Pacific system. Many of these auxiliary lines had been separated and independently reorganized. Not only were the Oregon Short Line, the Oregon Railway and Navigation Company, and the Union Pacific, Denver and Gulf no longer parts of the system, but a number of important agricultural feeders had been separated from the parent company and were now operated independently. Of the old system of about 8,000 miles, nothing was left but the main line from Omaha to Ogden, the Kansas Division from Kansas City to Cheyenne, and about 300 miles of shorter branches. Of these branches which were still owned, several continued to be operated by receivers, even after the new management took charge of the main line; but their securities were owned by the Union Pacific, subject to such of the collateral trust notes of 1891 as were still afloat. Early in 1898 the reorgan-

⁵ Burton J. Hendricks, "The Most Powerful Man in America," *McClures*, Oct. 1909.

ization committee purchased a sufficient amount of the collateral underlying these notes to retire the balance outstanding.⁶ The remaining securities of these branches which had been held in this trust were therefore released, so that the new company had in these 300 miles the beginning of a branch system.⁷

In June, 1898, it was announced that the new company had acquired, at a large discount, nearly all of the bonds of the Omaha and Republican Valley Railway,⁸ so that when that road was sold under foreclosure, in August, 1898, title to it passed to the new Union Pacific Railroad Company.⁹ During the same year, 1898, the Union Pacific, Lincoln and Colorado road, a local line in western Kansas, and formerly a part of the Union Pacific system, was consolidated with the Union Pacific Railroad.¹⁰ The Central Branch Union Pacific was permanently separated from the Union Pacific, but this line had never been an integral part of the old system; and control of the St. Joseph and Grand Island road was not again acquired by the Union Pacific until 1906. With these two exceptions the Union Pacific lines in Kansas and Nebraska again included substantially the same agricultural feeders which were included in the former system. The Union Pacific, Denver and Gulf road, which had also included the Colorado mineral branches, remained independent of the Union Pacific, but an arrangement was made with the reorganization committee of the latter

⁶ Chron., 66: 2906 (1898).

⁷ These branches which, as well as the main line, were subject to the new first mortgage were:

	miles
Brighton and Boulder branch	27.
Carbon Cut-Off Railway (Allen, Wyo., to Hamer, Wyo.).....	19.06
Echo and Park City Railway	30.19
Junction City and Fort Kearney Railway	88.
Kearney and Black Hills Railway	65.72
Salina and Southwestern Railway	35.74
Solomon Railroad	57.04
	<hr/>
	322.75

⁸ Chron., 66: 617, 1190; 67: 179 (1898).

⁹ *Ibid.*, 67: 372 (1898). This road was a system of local feeders in eastern Nebraska.

¹⁰ *Ibid.*, 66: 385; 67: 957 (1898). This line was an alternate route from Salina, Kansas, to Oakley, Kansas, both stations on the main line of the Kansas Division. The length of the road was 225 miles.

road whereby the Union Pacific reacquired by purchase the important cut-off from Julesburg to La Salle, Colorado, which enabled the Union Pacific to share in the business of Colorado.¹¹

The new company was not organized by special charter, as was the old company, but was organized under the general laws of Utah. The articles of association contained no restriction regarding branch extensions as was impliedly contained in the old charter. It was therefore no longer necessary to operate these branches through the medium of separate corporate organizations.¹² Their acquisition had been financed without increasing the new company's authorized capitalization, the plan of reorganization having provided sufficient capital to carry out this purpose. In fact, something over 1,000 miles of this newly reacquired branch line mileage was unincumbered by any issue of bonds.

The Oregon Short Line and Oregon Railroad and Navigation Company

The next step in the direction of expansion was the re-acquisition of the Oregon Short Line and the Oregon Railroad and Navigation Company. As the Union Pacific had paid the assessment called for under the Oregon Short Line reorganization plan, it still held a large interest in the Oregon Short Line; but the latter road had after the foreclosure mentioned in the preceding chapter been reorganized under a plan which placed the control of the company in the hands of the former bondholders. Of its capital stock amounting to \$27,460,100, par value, the Union Pacific owned about eight millions, and later during the year 1898, it purchased enough additional shares to give it a substantially controlling interest.¹³ On January

¹¹ Chron., 66: 521 (1898); 68: 188 (1899).

¹² There was no positive restriction in the charter acts of 1862 and 1864 which forbade branch line construction; but no provision was made respecting branches, and the act expressly gave to the company only the power to build a line of railroad from the Missouri River to California, together with the three specified branches, to Kansas City, Atchison, and Sioux City.

No court ever passed upon the legality of the right of the company to build branches; but the restriction was assumed, and then evaded through the subsidiary scheme.

¹³ Chron., 68: 87 (1899).

10, 1899, the Union Pacific stockholders voted to increase the common stock of the Union Pacific by \$27,460,100 for the purpose of acquiring the Oregon Short Line.¹⁴ This new Union Pacific stock was offered to stockholders of the Oregon Short Line in exchange for their stock, each stockholder of the Short Line to be entitled to one share of new stock of the Union Pacific in exchange for one share of Short Line stock plus an additional payment of \$3 for each share exchanged. The offer appeared attractive to the Oregon Short Line stockholders, for nearly all of them accepted. By the close of the year 1899 the Union Pacific had in this way acquired all but a few shares of the stock of the Short Line.

The Oregon Short Line still owned a majority of the common stock of the Oregon Railroad and Navigation Company, but this stock did not give to it control of that company. The old Oregon Railway and Navigation Company had been reorganized in 1897, the name of the reorganized company being changed to the Oregon Railroad and Navigation Company. The preferred stockholders of this reorganized company controlled it. Under the plan of reorganization a voting trust had been established which provided that for a period of five years, or until dividends aggregating 20 per cent on the preferred stock had been paid, the preferred stockholders of the Oregon Railroad and Navigation Company were to elect two-thirds of the directors. On account of this arrangement which prevented the Union Pacific, after having acquired the Oregon Short Line, from exercising complete control over the Navigation Company through the Short Line, the Navigation Company was operated independently, but in the joint interest of the Union Pacific, the Northern Pacific, and the Great Northern. Of this necessary 20 per cent dividend which must be paid before the voting trust could be dissolved, 10 per cent had been paid by 1899. The Union Pacific, through the Oregon Short Line, guaranteed payment of the remaining 10 per cent,

¹⁴ Chron., 68: 188 (1899).

whereupon the voting trust was dissolved and the Union Pacific came in full control of the Oregon Railroad and Navigation Company.¹⁵

The Union Pacific management proceeded still further to strengthen its control over this company just as it had done in the case of the Short Line. The authorized preferred stock of the Union Pacific was increased by \$25,000,000 and the authorized common stock by \$7,718,600. This new stock was offered to stockholders of the Oregon Railroad and Navigation Company in exchange for their shares of the latter company.¹⁶ Each class, preferred and common, of Oregon Railroad and Navigation Company stock exchanged, share for share, with the corresponding class of new Union Pacific stock.¹⁷ Within a few months all but a negligible minority of shares of the Navigation Company were exchanged for new preferred and common shares of Union Pacific stock. From this time on the Northern Pacific and Great Northern were no longer accorded equal advantages with the Union Pacific over the Oregon Railroad and Navigation Company. The three properties, the Union Pacific, the Oregon Short Line, and the Oregon Railroad and Navigation Company, have since been operated as one road, although the Short Line and the Navigation Company have been operated under separate corporate organizations. In the Union Pacific annual reports before 1902 separate reports had been published covering the business of the auxiliary companies, but since 1902 no separate report has been made of the operations of these three constituent members of the Union Pacific system; the operations of the

¹⁵ Chron., 69: 181 (1899).

¹⁶ Minutes of directors' meeting, Aug. 29, 1899, Proc. Spec. Ex., p. 58.

¹⁷ There were outstanding against the Oregon Short Line two series of income bonds, series A, amounting to \$7,185,000, and series B, amounting to \$14,841,000. The latter were secured by a pledge of \$16,281,400, Oregon Railroad and Navigation Company common stock. The new \$25,000,000 of Union Pacific preferred were used to retire the series B income bonds and acquire \$11,000,000 of Oregon Railroad and Navigation Company preferred stock. The increased Union Pacific common stock was exchanged for the Oregon Railroad and Navigation Company common stock outstanding, \$7,718,600 out of the total authorized issue, \$24,000,000. The series A income bonds were retired out of the Union Pacific's reserved funds. (Proc. Spec. Ex., pp. 59, 60.)

entire system have been reported as though the three roads were in name, as well as in fact, one company.

The Union Pacific system now included substantially the same mileage as it had included prior to 1890, the date of the acquisition of the Union Pacific, Denver and Gulf road. Certain branches were, however, noticeably absent. The old South Park Line to Leadville and Gunnison, which had been such a conspicuous example of a branch that was a "sucker" instead of a feeder, was not any more a part of the system. Other Colorado mineral lines were no longer included, nor were there included the two agricultural roads in eastern Kansas which have been mentioned, the St. Joseph and Grand Island, and the Central Branch Union Pacific. Of the lines which remained as part of the system all but the Oregon Short Line, the Oregon Railroad and Navigation Company, and one other line, the Leavenworth, Topeka and Western (formerly the Kansas Central), were operated without the intervention of subsidiary corporate organizations. The reorganization of the Oregon Short Line and of the Oregon Railroad and Navigation Company had materially reduced the fixed charges of each road, so that both of these companies became self-sustaining. The Union Pacific was therefore in a position to enjoy the benefits of a system of feeders and auxiliary lines, while it was not called upon to make good annual deficits upon branch line bonds.

Purchase of the Southern Pacific

So far the new management of the Union Pacific had confined itself to the work of building up and strengthening the Union Pacific system, by restoring, so far as seemed advisable, the auxiliary system as it had existed prior to the receivership. In 1901 a more radical step was taken. This was the purchase by the Union Pacific of a controlling interest in the Southern Pacific Company, which had since 1885 owned the Central Pacific line from Ogden to San Francisco. The principal

stockholder of the Southern Pacific, Collis P. Huntington, died in 1900, and his stock was known to be on the market. The Union Pacific managers appear to have been somewhat apprehensive lest this stock, which represented a dominating, if not a controlling interest, should pass into the hands of interests hostile to their company, with a possible result that the free interchange of business between the Union Pacific and Southern Pacific at Ogden might cease.¹⁸ If we are to credit the statements of Harriman and Kahn, an attempt was made by the Union Pacific to purchase the Central Pacific line from the Southern Pacific Company. Failing in this attempt, the Union Pacific managers determined to acquire a controlling interest in the Southern Pacific itself. Early in 1901 the Union Pacific purchased, through Kuhn, Loeb and Company, the Huntington holdings of Southern Pacific stock and also a large block of the stock of the same company which was then held by the house of Speyer and Company.¹⁹ These shares, together with some additional shares which were purchased in the open market, gave to the Union Pacific something over \$75,000,000 of Southern Pacific stock out of a total issue of \$200,000,000. During the next few months the Union Pacific acquired about \$15,000,000 more of Southern Pacific stock, so that by the close of the year 1901 it owned over 45 per cent of the entire issue, an amount which enabled it to control the management of the Southern Pacific Company.

The original \$75,000,000 stock purchase, which cost the Union Pacific a little over \$50 a share,²⁰ was financed by the issuance of \$100,000,000 of 4 per cent convertible bonds, secured by a pledge of the newly acquired Southern Pacific

¹⁸ Pro. Spec. Ex., p. 4712, testimony of Otto H. Kahn. The Rio Grande system was the hostile interest which the Union Pacific feared.

¹⁹ Minutes of directors' meeting, Feb. 20, 1901, Proc. Spec. Ex., p. 63; also testimony of Kahn before the Interstate Commerce Commission in 1907, printed in *Ibid.*, p. 1215. (The testimony taken during the investigation of 1907 has never been separately printed, but much of it was entered as evidence in the Proceedings before the Special Examiner in 1909 and 1910 and printed in the record. Where this is the case, references will be hereafter in this form: "Evidence before I. C. C., Proc. Spec. Ex.")

²⁰ Evidence before I. C. C., Proc. Spec. Ex., p. 1217, testimony of Kahn.

stock, as well as by a first mortgage upon the branch roads which had up to this time been unincumbered, and by a second mortgage on the Union Pacific lines which were already covered by the company's first mortgage.²¹ These bonds were to be convertible at par into Union Pacific common stock at any time before January 1, 1907. The issue was underwritten by Kuhn, Loeb and Company, stockholders being first offered the privilege of subscribing to them at par. Forty millions of these bonds were required to purchase the Southern Pacific stock; the balance of the issue was used later for a different purpose, which will be considered later in this chapter.

Unified Operation of Union Pacific and Southern Pacific

The Southern Pacific Company was and is a holding company, which was organized in 1885 under a special charter granted by the state of Kentucky.²² As a holding company, it owned the Southern Pacific lines from San Francisco and Los Angeles east to El Paso, Texas; the Galveston, Harrisburg and San Antonio Railway and a number of other companies which operate lines in Texas and Louisiana, and give the Southern Pacific a through line to New Orleans; the Central Pacific line from San Francisco to Ogden; the line from Sacramento to Portland; and many shorter branches. The system embraces what are known as the Sunset, Ogden and Shasta routes, the Sunset Route being the line from San Francisco to New Orleans, the Ogden Route, the old Central Pacific line, and the Shasta Route the road from San Francisco to Portland. A great number of subsidiary corporations make up the entire system which is owned by the Southern Pacific Company. This company also owned, and still owns, what is known as the Morgan line of steamers, which operate between New Orleans and New York, and in 1900, the Southern Pacific purchased a majority of the stock of the Pacific Mail

²¹ Minutes of directors' meeting, Feb. 20, 1901, *Ibid.*, p. 65.

²² Laws of Kentucky, 1884, Vol. I, p. 75.

Steamship Company, which operates between San Francisco and the Orient, and between San Francisco and Panama.²³ Before it purchased the Southern Pacific, the Union Pacific already owned, through the Oregon Railroad and Navigation Company, a line of steamships from Portland to the Orient, known as the Portland and Asiatic Steamship Company, and a line between Portland and San Francisco, and in addition it owned a half-interest in the Occidental and Oriental Steamship Company, which operated between San Francisco and the Orient.

The above description of the properties controlled by the Union Pacific and Southern Pacific indicates the magnitude of the combination of these two great railroad systems. But the mere size of this combination is not the only characteristic which distinguishes it from other railroad mergers. The railroad situation in the far west is materially different from the situation in the east and middle west, where there is a network of railroad lines of many different companies. In 1901 the only big railroads in California were the Southern Pacific and the Atchison, Topeka and Santa Fé. The latter company lacked an extensive system of branch lines and feeders, while the Southern Pacific had built into almost every part of California. The only railroads in Oregon were the Southern Pacific and the Oregon Railroad and Navigation Company, except that the rails of the Northern Pacific touched Portland. A glance at the map will show that there are relatively few rail lines in the far west, and that the most important lines in the southwest are owned either by the Union Pacific, the Southern Pacific, or the Santa Fé. In 1901 neither the Spokane, Portland and Seattle road, nor the Western Pacific, nor the Los Angeles and Salt Lake line had yet been built.

The Union Pacific-Southern Pacific combination controlled therefore the following transcontinental routes: from the Missouri River to Portland, via the Oregon Short Line; from the

²³ Evidence before I. C. C., Proc. Spec. Ex., p. 1667, testimony of R. P. Schwerin.

Missouri River to San Francisco, via the Ogden Route; from New York, via the Sunset-Gulf route, to San Francisco and Portland; and that portion of the route via Panama which extends from Panama to San Francisco. The acquisition of the Southern Pacific differed therefore in one important respect from the former additions to the Union Pacific system. The previous acquisitions had not, except in the case of the Kansas Pacific, been competing lines, and had not involved the question of "restraint of trade." Indeed it happened more often that newly constructed or acquired lines had stimulated competition by enabling the Union Pacific to become a factor, as in the case of the Julesburg branch, or the Oregon Short Line. The Union Pacific-Southern Pacific combination, on the other hand, was a union of two competing railroad companies into the nearest approach to a railroad monopoly which had yet been developed in the United States.

After the combination, Union Pacific officials and directors were elected to the offices of the Southern Pacific Company. Harriman became the president of the Southern Pacific, and the principal offices of both companies were generally held by the same individuals. The "Four Pacifics"—the Union Pacific, the Oregon Short Line, the Oregon Railroad and Navigation Company, and the Southern Pacific—were from this time on operated as one consolidated system. The general offices of the two systems, the Union Pacific and Southern Pacific, were consolidated in all the principal cities of the United States, except in New York.²⁴ J. C. Stubbs, who had been traffic manager of the Southern Pacific, was appointed "Director of Traffic" of the combined system; and Julius Kruttschnitt, a prominent officer of the Southern Pacific, became "Director of Maintenance and Operation" of the combined roads. The business of these two men was to operate the Union Pacific and Southern Pacific systems with a view to the welfare of the system as a whole. Said Stubbs in 1911:

²⁴ Chron., 73: 446 (1901).

I am to be placed in entire charge of the traffic of the Southern Pacific, the Union Pacific, the Oregon Railroad and Navigation Company, and the Oregon Short Line and I shall report to the Boards of Directors of the several companies. That means that I am to report direct to Harriman, the Chairman of the Executive committees of the four roads.²⁵

Attempted Control of the Northern Pacific

Further discussion of the Union Pacific-Southern Pacific system must be deferred for a time, in order that the thread of events may not be broken. A short time after the Union Pacific acquired control of the Southern Pacific, a great struggle between the Harriman-Union Pacific interests, and the Hill-Great Northern interests took place. This struggle arose as a result of a dispute over the control of the Chicago, Burlington and Quincy Railroad. The Burlington system extended from Chicago through Omaha to Denver, where it connected with the Union Pacific and the Denver and Rio Grande; from Omaha to Billings, Montana, where it connected with the Northern Pacific; and from Chicago to St. Paul, where it connected with the Northern Pacific and the Great Northern. The Burlington Road also owned a network of branch lines in the Mississippi River region and in the "Granger States" of the middle west. It had been an active competitor of the Union Pacific, but it was also a valuable connection and a considerable amount of business was interchanged between the two systems.²⁶ It seems that during the year 1900, Harriman attempted to obtain an interest in the Burlington, with a view to maintaining and strengthening harmonious relations between that road and the Union Pacific. Accordingly he entered into negotiations with the Burlington management for the purchase of 10 or 15 per cent of the company's capital stock.²⁷ Otto H. Kahn subsequently declared that the purpose of this move was to maintain the status quo and so prevent the Burlington from

²⁵ Chron., 72: 1239.

²⁶ Proc. Spec. Ex., p. 4715, testimony of Kahn.

²⁷ *Ibid.*, p. 4716, testimony of Kahn.

falling into the hands of interests hostile to the Union Pacific; for it had been reported that the people who had theretofore been in control of the Burlington were about to retire from the management. By the term "hostile interests" was meant, it seems, the Great Northern. It had been rumored that James J. Hill, who controlled the Great Northern, wished to purchase the Burlington.²⁸ According to Kahn's testimony, it was the object of the Union Pacific interests to maintain the "independence of the Burlington," and that if the Harriman interests could control 15 per cent of the Burlington's stock, this object would be accomplished.

The negotiations between Harriman and the men in control of the Burlington fell through on account of the high price which the latter asked for the Burlington stock.²⁹ About the same time both the Great Northern and the Northern Pacific roads were seeking control of a line which would give them an outlet to Chicago.³⁰ During the fall of 1900, it seems that the Union Pacific interests, after the failure of their negotiations with the Burlington management, had purchased in the open market some eight or nine millions of Burlington stock.³¹ This circumstance, according to one authority, may have been the deciding factor in inducing the two Northern roads to seek control of the Burlington in preference to one of the four or five other lines which would have given them an equally favorable connection with Chicago. "The testimony does not show a direct causal connection between the attempt of the Union Pacific to purchase the Burlington in the open market, and the negotiations of Hill for the same property, although more than mere coincidence probably existed."³²

The Burlington road had enjoyed prosperity for many years. It had been conservatively managed and it paid regular

²⁸ Proc. Spec. Ex., p. 4717, testimony of Kahn.

²⁹ *Ibid.*, p. 4716.

³⁰ B. H. Meyer, A History of the Northern Securities Case, p. 239.

³¹ Proceedings before the Special Examiner in the Northern Securities case, Vol. II, pp. 74-75, cited by Meyer, p. 230.

³² Meyer, p. 230.

dividends. Its stock was widely scattered, and held by persons who had owned their shares for many years, and who were not especially desirous of parting with them.³³ Control of the property could not be obtained by purchases made in the open market. About Christmas, 1900, the Hill interests opened negotiations with the Burlington management for the joint purchase, not of 15 per cent, but of all of the stock of the Burlington by the Great Northern and the Northern Pacific. Mr. Hill, it seems, was willing to pay a price which Harriman had refused to pay.³⁴ After some negotiations in the early spring of 1901, nearly all of the Burlington stockholders accepted the offer of the Great Northern and Northern Pacific roads and transferred 96.79 per cent out of a total of \$108,000,000 of Burlington stock to the two Northern companies in consideration of \$200 a share, payable in Great Northern and Northern Pacific joint collateral 4 per cent bonds. These bonds were secured by a pledge of this Burlington stock.³⁵ The Great Northern and Northern Pacific each received half of the stock which was so purchased.

The Union Pacific interests no longer owned the Burlington stock which they had purchased in the open market,³⁶ and it seems that relations which at that time existed between Harriman and Hill were not friendly. There was reason to expect that the control of the Burlington by Hill would result in "the deflection of the Burlington's entire relations from the Union Pacific to the Northern Pacific, and the consequent shutting out of the Union Pacific from that immediate territory."³⁷ Hill's avowed object in purchasing the Burlington was to divert * the traffic between the Mississippi Valley and the Pacific northwest from the Union Pacific to the Great Northern road.³⁸ This traffic must have been worth seeking, for it seems Harri-

³³ *Ibid.*

³⁴ Proc. Spec. Ex., p. 4717, testimony of Kahn.

³⁵ Consolidation and combinations of carriers subject to the act to regulate commerce, including the method of association known as the "Community of Interest Plan." (Order and Testimony, pp. 36-9, testimony of J. J. Hill.)

³⁶ Meyer, p. 231.

³⁷ Proc. Spec. Ex., p. 4717, testimony of Kahn.

³⁸ In the matter of Combinations, etc., pp. 52-4, testimony of Hill.

man did what he could to prevent his Northern competitors from securing it at the expense of the Union Pacific. At least this is declared to have been the motive which led Harriman to ask of the Hill people that his interests be permitted to share in the Burlington purchase.³⁹ This request of the Union Pacific interests was, however, flatly refused.

Thereupon Harriman and his associates in the Union Pacific determined to fight. During April, 1901, he and his fellow director, Winslow Pierce, made, on behalf of the Union Pacific, large purchases of Northern Pacific stock, with a view to acquiring control of that company, and, through it, a half-interest in the Burlington. During April and May, 1901, the Union Pacific interests succeeded in acquiring \$78,000,000 of Northern Pacific stock, out of a total issue of \$155,000,000, preferred and common. Of the Northern Pacific's authorized capital stock, \$80,000,000 were preferred and \$75,000,000 were common. The Harriman interests had acquired \$41,000,000 of preferred, and \$37,000,000 of common, which together gave them a majority of \$1,000,000 out of the total number of shares.⁴⁰ The cost of this Northern Pacific stock was met partly out of the remaining \$60,000,000 of the \$100,000,000 convertible bond issue, which had been authorized when the Union Pacific bought the Southern Pacific, and partly by borrowing money on short-time loans. The entire Northern Pacific purchase cost the Union Pacific between \$80,000,000 and \$90,000,000.⁴¹

This activity of the Union Pacific interests aroused the individuals whose interests lay with the Northern roads. Hill and his associates likewise made large purchases of Northern Pacific stock about the same time, in order that they, and not Harriman, might be in control. Early in May the struggle between the two factions over the Northern Pacific reached a crisis. Much of this company's stock had been sold short,

³⁹ Proc. Spec. Ex., p. 4717, testimony of Kahn.

⁴⁰ Meyer, p. 232.

⁴¹ Evidence before I. C. C., Proc. Spec. Ex., pp. 741-5, testimony of Harriman.

and when only a limited supply, which was not equal to the demand, was to be had, Northern Pacific common advanced rapidly, and on May 9, 1901, it touched the high figure of \$1,000 a share.⁴² This precipitated a stock exchange panic. "The markets of the world were convulsed, the equilibrium of the financial world shaken, and many speculative interests in a critical condition."⁴³

At first it appeared as if the Harriman interests had won out; but, unfortunately for them, the charter of the Northern Pacific gave to the common stockholders the right to retire the preferred stock on any 1st of January prior to 1917. Harriman's majority was in the preferred shares, while the Hill interests controlled slightly over half of the common shares. The latter faction could therefore retire Harriman's preferred shares, but Harriman held enough stock to make him a dangerous opponent. The rival interests finally concluded to compromise their differences. Just what negotiations took place cannot be learned; but on June 1, 1901, it was announced that an agreement between them had been reached whereby Harriman and two of his associates were to be admitted to the Northern Pacific board.⁴⁴ Both parties from now on acted in harmony.

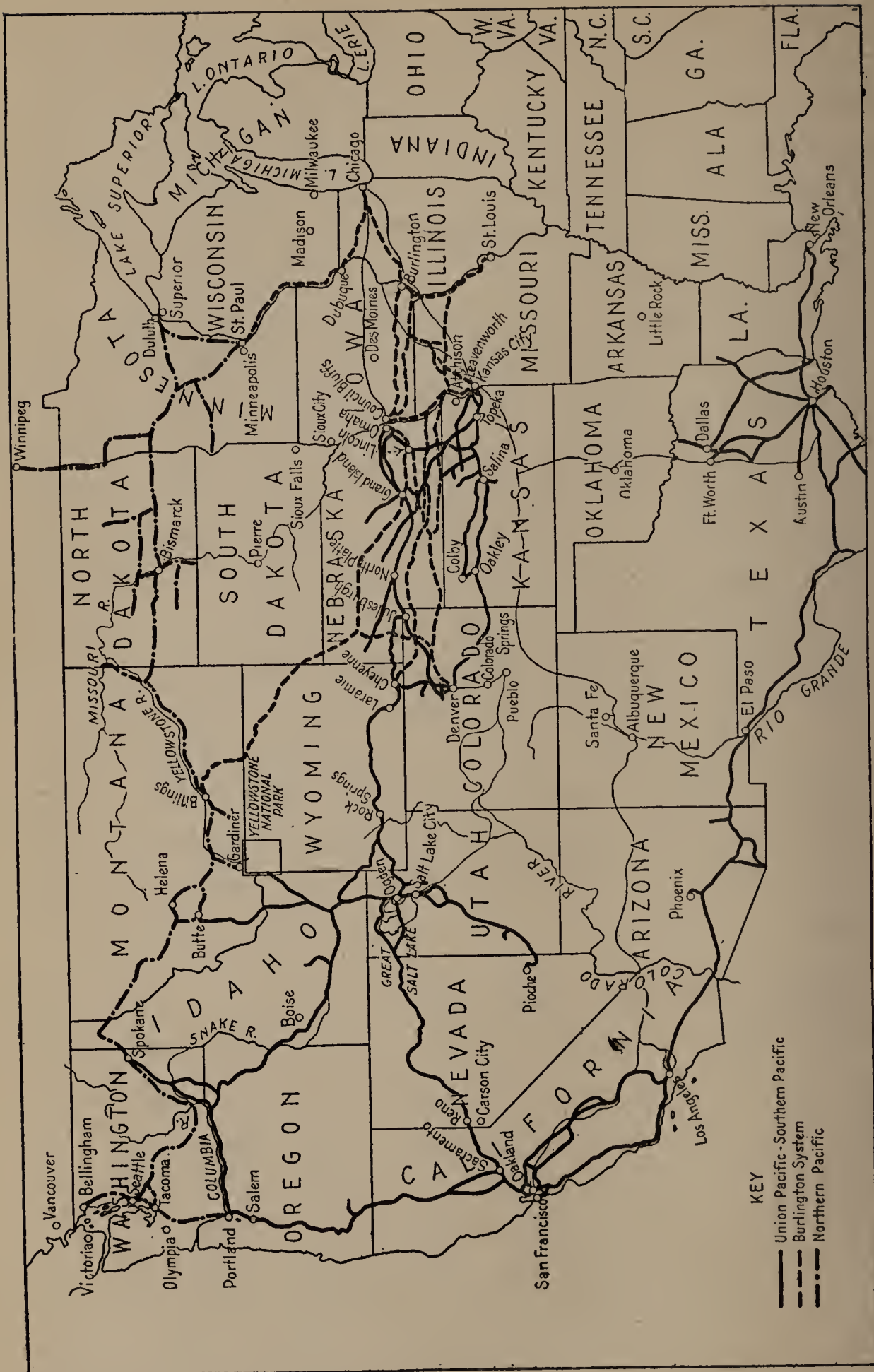
The Northern Securities Company

This settlement which accorded to the controlling power of the Union Pacific a minority representation in the Northern Pacific, was an example of the new "community of interest" principle. The day of cut-throat competition between rival railroad systems was rapidly passing, and was being succeeded by harmony and co-operation. As the term "community of interest" suggests, it implies the establishment of closer rela-

⁴² Meyer, p. 233.

⁴³ Argument of James M. Beck, Assistant Attorney-General of the United States, in *United States v. Northern Securities Company et al.*, p. 30 (C. C. U. S. 8th Cir.), quoted in Meyer, p. 233.

⁴⁴ Meyer, p. 235. Thus while the Harriman interests failed to secure complete control they received an important representation in the Northern Pacific.



Map Showing Relation of Union Pacific-Southern Pacific Lines with the Burlington and Northern Pacific. Not all branches are shown, while some lines that are shown, like the Lucin Cut-off over Great Salt Lake, have been built since 1901.

tions and friendly interests among different railroads. The method by which this result has usually been accomplished, and which is generally meant when this phrase is used, is the "interlocking directorate," so-called, that is, an arrangement by which one or more men prominent in the management of one company are represented in the directorate of another. Says one leading financial journal:⁴⁵

The community of interest idea does not contemplate or require for its successful working the actual holding of a majority interest. It aims merely at sufficient identity of interest to insure harmonious and peaceful arrangements between companies in the same field of operations.

The agreement which ended the hostility between the Hill and Harriman factions was declared to be in the interests of peace, and "complete and perfect harmony,"⁴⁶ and was commented upon as an example of "the vitality and vigor of the peace policy established between railroads."⁴⁷

Before the close of the same year, 1901, the interests in control of the Northern Pacific and Great Northern determined to organize a holding company to control both of these railroads, and through them, the Burlington. In November, 1901, it was announced that such a company to be known as the Northern Securities Company was to be organized under the laws of New Jersey for the purpose of holding the stock of the Great Northern and Northern Pacific.⁴⁸ The Northern Securities Company was an embodiment of the "community of interest" principle. Unity, not division of interests was declared to be its object. "The intent was not to allot so many directors to the Union Pacific, so many to the Great Northern, and so many to the Northern Pacific, but rather to form the strongest and most harmonious combination possible representing the joint interests involved."⁴⁹ The new com-

⁴⁵ Chron., 78: 1196 (1904)

⁴⁶ *Ibid.*, 73: 104 (1901).

⁴⁷ *Ibid.*, 73: 978 (1901).

⁴⁸ *Ibid.*, 73: 1011 (1901).

⁴⁹ *Ibid.*, 73: 1011 (1901).

pany was capitalized at \$400,000,000. Its stock was to be issued to stockholders of the Great Northern and Northern Pacific in exchange for their stock. The exchange was to be made on the following basis: Great Northern stock exchanged for Northern Securities Company stock at the ratio of \$100 par value of Great Northern for \$180 par value of Northern Securities Company; and Northern Pacific exchanged at the ratio of \$100 par value for \$115 par value of Northern Securities Company stock.

The Union Pacific, as the owner of some \$78,000,000 of Northern Pacific stock, chose to exercise its privilege of turning its shares into the Northern Securities Company in exchange for Northern Securities Company shares amounting in number to about one-fifth of the capital stock of the new corporation. The number of directors of the Northern Securities Company was fifteen. Three Union Pacific directors were elected to the board of directors of the Northern Securities Company, Harriman, Schiff, and James Stillman, and Harriman became a member of the executive committee of the holding company.

The Northern Securities Company enjoyed but a brief existence. Almost immediately it was charged with being a combination in restraint of trade. In December, 1901, the Interstate Commerce Commission commenced an investigation of the company. Suits were also instituted against it both by state and national authorities, the details of which need not be set forth in this work.⁵⁰ The validity of the combination finally came before the Supreme Court of the United States, and on March 14, 1904, the ownership of the Great Northern and Northern Pacific Railways by the Northern Securities Company was declared to be a combination in restraint of trade, and, as such, in violation of the Sherman Anti-Trust Law of 1890. The court enjoined the Northern Securities

⁵⁰ For full details of the history of the Northern Securities Company, see Meyer, *History of the Northern Securities Case*.

Company from voting its holdings of Great Northern and of Northern Pacific stock, and from collecting any dividends upon the same.⁵¹

Second Attempt to Control Northern Pacific

But the court's decree failed to direct the manner in which the combination should be dissolved. After the decision was announced, a dispute arose over the redistribution of the Securities Company's holdings. It was manifest that the situation had become very complicated. On April 21, 1904, the stockholders of the Northern Securities Company met and voted to reduce that company's outstanding capital stock from 3,954,000 shares to 39,540 shares.⁵² Of the shares outstanding 99 per cent were to be called in and canceled, the plan being for each holder to receive for one share of Northern Securities stock, \$39.27 in Northern Pacific stock, \$30.17 in Great Northern stock, and one share of Northern Securities Company "stubs." These were certificates of interest in the remaining 1 per cent of Northern Securities stock, which represented certain other assets of the company other than Northern Pacific and Great Northern holdings. The practical effect of this plan was obviously to leave the control just where it was, the only change being that it would now be exercised by the same stockholders as individuals, who had previously managed the road through the medium of this holding company.

The above arrangement for a prorata distribution would give the Union Pacific about \$28,000,000, par value, of Northern Pacific stock, and about \$21,500,000, par value, of Great Northern. This plan was unsatisfactory to the Harriman interests. They at once protested against it, and demanded a return of the \$78,000,000 of Northern Pacific stock which they had turned into the Securities Company at the time of its

⁵¹ *Northern Securities Company v. United States*, 193 U. S. 197, 24 S. Ct. 436, 48 L. Ed. 679.

⁵² Meyer, p. 280.

formation.⁵³ Had this been done the Union Pacific would have been able to control the Northern Pacific; for after the Northern Securities Company had been organized, the Northern Pacific had retired its preferred shares by issuing \$80,000,000 of debentures which were convertible into Northern Pacific common stock, and which had been subsequently converted. In 1904 the capital stock of the Northern Pacific amounted, therefore, to \$155,000,000, of common shares, with no preferred stock. Had the Harriman interests carried their point, the Union Pacific-Southern Pacific system would have been united with the Northern Pacific-Burlington system, and there would have resulted the largest railroad merger which had yet been effected.

The majority stockholders of the Securities Company refused to listen to this proposition, and insisted upon carrying out their original plan for a prorata distribution. The Harriman interests thereupon resorted to the courts, and commenced a suit to compel the return to the Union Pacific of the whole number of Northern Pacific shares of which the Union Pacific had been the owner in 1901.

The contention of Harriman's attorneys was that under the Supreme Court's decree the Northern Securities Company had been adjudged to be not a purchaser or owner of the shares deposited but simply a custodian; that inasmuch as it had received and held shares of the Northern Pacific and Great Northern roads contrary to law, it had acquired no title to them and consequently possessed no right to transfer any rights in respect to them. "The whole transaction was illegal, ultra vires, and void from the beginning to the end." It was argued that when property is transferred for an illegal purpose which has been terminated, the holder must return the property on demand. Counsel for the Harriman interests also pointed out that under the proposed prorata plan of distribution no real

⁵³ See *Harriman v. Northern Securities Company*, 197 U. S. 244, 25 S. Ct. 493, 49 L. Ed. 739.

change in the ownership of the Great Northern and Northern Pacific would result, and that as a consequence if that plan were adopted, the effect of the decision of the United States Supreme Court would be nullified.⁵⁴

A complete discussion of the case is not necessary in this work. The suit was commenced in April, 1904, and on July 14, 1904, the United States Circuit Court issued a preliminary injunction restraining the execution of the prorata plan of distribution, pending the final settlement of the suit upon its merits. An appeal was taken from the injunctive order, and on the 3rd of January, 1905, the Circuit Court of Appeals reversed the order of the lower court and dissolved the injunction.⁵⁵

The case was brought before the United States Supreme Court two months later upon a writ of certiorari, and upon the 6th of March, 1905, a decision was handed down which not only unanimously upheld the decision of the Circuit Court of Appeals, reversing the order granting a preliminary injunction but in addition disposed of the suit upon the merits.⁵⁶ The court held that the transaction whereby the Northern Securities Company acquired the Union Pacific holdings of Northern Pacific stock had been one of purchase and sale. The former decree had not declared the sale void; it had merely restrained the holding company's power to vote and to collect dividends, and thereby had placed a premium upon a dissolution of the holding company. Those who deposited shares of Northern Pacific and Great Northern with the Northern Securities Company had received valuable consideration in exchange. Harriman and his associates had been a party to these proceedings and had publicly held out the Northern Securities Company as the owner of shares of Great Northern and Northern Pacific. Many third parties had purchased Northern Securities Com-

⁵⁴ Meyer, p. 291.

⁵⁵ *Northern Securities Company v. Harriman*, 134 Fed. 331.

⁵⁶ *Harriman v. Northern Securities Company*, 197 U. S. 244, 25 S. Ct. 493, 49 L. Ed. 739.

pany stock upon the strength of this assurance, and their equities, said the court, "were too plain to be ignored." The delivery of the Northern stock to the Union Pacific interests was of itself declared to be in contravention of the Sherman Law, for the Northern Pacific and the Burlington were both competitors of the Union Pacific.

Moreover, the Union Pacific could not obtain Northern Pacific common stock in return for its original preferred stockholdings, for the preferred stock had been retired when the convertible debentures had been issued and it had been asserted by the Hill party that their original intention had been to retire this preferred stock without affording to the preferred stockholders the right to participate in any new securities that might be issued for this purpose. Therefore the new stock into which the debentures had been converted was not, in the language of the court, "the natural increase of the old stock, but the result of the exercise of the right of subscription"⁵⁷ which had been expressly denied to the preferred stockholders. The court decided that the Union Pacific interests must be content with their proportion of the Securities Company's ratable assets, and denied to them the right to reclaim the specific shares with which they had parted. The case was remanded to the lower court with instructions to dismiss the suit.

This was the end of Harriman's attempt to control, through the Union Pacific, the Northern Pacific and the Burlington. He very nearly succeeded in accomplishing his purpose. Ordinarily in the case of a large corporation whose stock is widely scattered and held by many persons, the ownership of about 30 per cent of the stock is sufficient to control. The majority stockholders are unorganized, and usually either do not vote at all, or readily deliver their proxies to the men who are in control. Thirty per cent of a company's stock concen-

⁵⁷ *Harriman v. Northern Securities Company*, 197 U. S. 244, 298; 25 S. Ct. 493, 505; 49 L. Ed. 739, 764.

trated in a single holding will insure control in the absence of organized opposition.⁵⁸ Harriman had, through the Union Pacific, at one time been the possessor of an outright majority of the total number of shares of the stock of the Northern Pacific Railway Company, and he barely lacked a majority of the company's common shares, of which he held slightly less than 50 per cent. A powerful combination of opposing capitalists, aided by the result of legal proceedings, prevented the extension of the Harriman-Union Pacific control over the Northern Pacific and the Burlington roads.

The expansion development of the Union Pacific from the time of the reorganization down to 1905 has now been outlined. The period was marked by a rapid and unprecedented increase in the mileage which the company controlled. Most of the auxiliary lines which had been a part of the old system, including the Oregon Short Line and the Oregon Railroad and Navigation Company, were acquired. Early in 1901 the Southern Pacific Company was added to the Harriman system. Later in the same year an attempt was made to control the Northern Pacific and the Burlington; and, while the Union Pacific failed to get absolute control of these companies, it eventually acquired as its share of the assets of the Northern Securities Company a considerable minority holding, or "community of interest" in the Great Northern and Northern Pacific, which was equal to about one-fifth of the capital stock of each of these two roads.

Financial Organization of Union Pacific

The internal history of the reorganized Union Pacific Railroad Company must now be considered. The question naturally arises how could a railroad company which had for years had more or less difficulty in meeting its ordinary obligations, and which had barely emerged from bankruptcy, engage in transactions involving millions of expenditure for the purpose

⁵⁸ Evidence before I. C. C. Proc. Spec. Ex., p. 1244, testimony of Kahn.

of acquiring large stockholdings in other railroads? Where could it secure the credit necessary to float at par the hundred millions of low-interest-bearing convertible bonds by means of which these large acquisitions were made; and how was it that a railroad which had been driven into a receivership under the burden of heavy and excessive fixed charges could afford to assume the interest upon such large additional bond issue?

In the first place the road's fixed charges had been greatly reduced by the reorganization. The annual interest upon the authorized issue of \$100,000,000 of first mortgage bonds was but \$4,000,000, while the interest charges of the old company had been nearly double that figure. In place of interest upon bonds, which was fixed, had been substituted dividends upon stock, which were contingent upon the company's earnings. Moreover, a number of important branches were unincumbered by any lien, until 1901, when the company issued its convertible bonds. The Oregon Short Line and the Oregon Railroad and Navigation Company had been acquired by increasing the capital stock of the Union Pacific, instead of by the more familiar method of issuing collateral trust fixed-interest-bearing bonds secured by a pledge of the stock which was acquired, or by mortgaging assets of the company. These two roads, the Short Line and the Navigation Company, had been so reorganized that both were self-sustaining, while at the same time they served as valuable feeders to the main line. Other branches of the old system which had proved too heavy a burden to be offset by their interchanged traffic were no longer a part of the new system.

In the next place the plan of reorganization of the Union Pacific had provided the company with a working capital. Not all of the new securities were issued at the time of the reorganization. It was provided by the terms of the first mortgage securing the \$100,000,000 bond issue, that \$5,000,000 of these bonds should be retained in the company's treasury and issued from time to time in amounts not to exceed

\$1,500,000 annually, the proceeds to be used for betterments. Of the balance of \$95,000,000 about \$90,000,000 of the first mortgage bonds were issued in exchange for the securities of the Union Pacific Railway. About \$5,000,000 remained, therefore, which were available for the acquisition of branch lines. Holders of the common stock of the old company had been required to pay a cash assessment of \$15 a share, or over \$9,000,000 in all. A bonus of \$3 a share was paid by each stockholder of the Oregon Short Line in exchanging Short Line shares for shares of new Union Pacific stock. The new company had also bought up certain claims against the old company at nominal prices, and in November, 1899, it received over \$5,250,000 as its share of the remaining assets of the old company.⁵⁹

Increased Earnings

The earnings of the new company increased rapidly after the reorganization. The lowest net earnings of the old company in twenty years had been in 1894, when they had amounted to slightly over \$4,250,000. The following two years, 1895 and 1896, showed gradual but comparatively slight increases; but the period was one of continual business depression which operated against any great improvement in the road's earnings. The political uncertainty, due largely to the Populist-Free Silver agitation, delayed the return of prosperity until after the election of McKinley in the fall of 1896. Business improved steadily and rapidly after 1896. Stimulated by a protective tariff, and freed from the threatened danger of Free Silver, a period of national prosperity commenced, which was reflected in the earnings of the Union Pacific. For the first six months of 1898 the net earnings of the 1,849 miles of main line of the Union Pacific exceeded \$3,000,000, and were at the rate of \$6,250,000 a year.⁶⁰ Each succeeding

⁵⁹ T. W. Mitchell, "The Growth of the Union Pacific and Its Financial Operations," *Quarterly Journal of Economics*, Vol. XXI, pp. 571 ff.

⁶⁰ Annual Report for 1898, p. 3.

year showed a steady increase in mileage, and in gross and net earnings. The new company took possession of the property in February, 1898. Less than a year thereafter a semiannual dividend of $1\frac{1}{2}$ per cent was declared upon the preferred stock, and in June, 1899, the preferred semiannual dividend rate was increased to its maximum of 2 per cent, or four per cent per annum. After dividends upon the preferred stock had been paid, the company had, for the fiscal year ending June 30, 1899, a surplus of nearly \$4,000,000.⁶¹

The company's revenue per ton per mile and per passenger per mile no longer declined steadily, as had been the case before and during the receivership. It is true that during the last few years of the century the rates actually charged on traffic between competitive points were at times demoralized; but the steady decline in rates of the earlier period appears to have been checked, and after 1901 rates were better maintained than at any time in the previous ten years.⁶² The average rate per ton per mile is by no means an infallible basis of comparison; but it does reflect the situation fairly well. In 1896 the average rate had been $\frac{98}{100}$ of 1 per cent⁶³ per mile while in 1901 it was 1.3 cents per mile.⁶⁴ The class and commodity rates which appear in the published tariffs show, notwithstanding occasional fluctuations, a tendency rather to advance than to decline, toward the close of the century.

The net earnings of the Union Pacific Railroad proper, not including the Oregon Short Line, or the Oregon Railroad and Navigation Company, from 1898 to 1901 were:⁶⁵

YEAR ENDING JUNE 30	MILES OPERATED	GROSS EARNINGS	OPERATING EXPENSES	NET EARNINGS
6 mos. 1898	1,849.29	\$ 7,670,579.30	\$ 4,534,418.16	\$ 3,136,161.14
1899	2,848.38	19,811,641.04	11,412,167.80	8,399,473.24
1900	2,023.45	23,046,907.33	13,322,222.82	9,724,684.51
1901	3,010.85	25,472,600.20	15,222,383.56	10,250,216.64

⁶¹ Annual Report for 1899, p. 3.

⁶² Interstate Commerce Commission Publications, Railways in the United States in 1902, Pt. II, "A Forty Year Review of Changes in Freight Tariffs," p. 163.

⁶³ Annual Report for 1897.

⁶⁴ Proc. Spec. Ex., p. 4094, testimony of Julius Kruttschnitt.

⁶⁵ Annual Reports.

Until 1901 these earnings were subject to a fixed charge of only \$4,000,000 a year. Aided by such a showing and by the fact that it was represented in the financial world by the banking house of Kuhn, Loeb and Company, the Union Pacific was able to float 4 per cent bonds at par, while the old company had been compelled to pay higher rates of interest on bonds that could not always be disposed of at par.

Physical Improvements and Betterments

A most important factor in the continued prosperity of the Union Pacific was the fact that the new management entered upon the policy of making physical improvements and betterments on a much greater scale than had ever been done before. That the road might reap the full benefits of the increasing national prosperity, and at the same time be fortified against periods of possible future depression, the Harriman management appropriated enormous sums for new equipment and for permanent improvements along the line. Harriman was a skilful stock operator; but he was also a thoroughly capable railroad manager. His management recognized the value of investing the company's available resources in money-saving improvements, and instead of dividing all the company's surplus earnings among the stockholders, these earnings were largely put into the property. It is in this respect that the Harriman management of the Union Pacific stands in strong contrast to the first Gould management from 1873 to 1883. Gould's policy of paying large dividends during the seventies and early eighties was to a great extent the cause of the later financial distress of the old company. Harriman followed a very different policy, with a correspondingly different result. Although the company's earnings rapidly increased, the dividend rate remained low. A semiannual dividend of $1\frac{1}{2}$ per cent upon the common stock was declared at the close of the year 1899, and was paid the following April. Before the close of 1900 the dividend rate upon the common stock was

increased to 4 per cent per annum,⁶⁶ but at this relatively low figure it remained for five years. After the payment of these dividends, a large surplus was left each year, which was available for permanent improvements. In addition to surplus earnings there were to be applied to the same purpose, under the terms of the first mortgage securing the \$100,000,000 bond issue, the entire proceeds arising from the sale of the company's lands.

The policy of making extensive physical improvements and betterments commenced as soon as the new management took charge. The old company had maintained the property fairly well up to the standards of the earlier period; but these standards fall far short of the advanced standards of the twentieth century. The Adams management had made many improvements in the property; but it had lacked the resources which were at the disposal of Harriman's engineers. During the financial troubles of the nineties the company was unable to make the necessary expenditures to keep abreast of the progress of modern railroad engineering. Although the phrase, "two rusty streaks of iron upon an old road-bed" does not fairly describe the property in 1898, many changes were necessary to bring the road up to the highest standards of a first-class modern twentieth century railroad.

Larger and heavier locomotives with increased hauling power, larger freight cars, and more modern passenger equipment were needed. It was necessary to strengthen and improve the road-bed in order to accommodate the heavier rolling stock. The economical handling of a large and increasing volume of traffic required great expenditures for the purpose of eliminating curves and reducing grades. Nearly \$3,000,000 were spent during the fiscal year ending June 30, 1899, in such improvements as new and heavier steel rails, ties, widening embankments, ballasting, and bridges.⁶⁷ A new passenger depot was

⁶⁶ Annual Report for 1900, p. 3.

⁶⁷ Annual Report for 1899, p. 7.

erected at Omaha, and new stations were built all along the line. The laying of heavier rails continued, until eventually the entire main line was laid with 90-pound steel rails. The original rails laid in the sixties had been 56-pound iron rails. Wooden bridges were replaced by steel. The road-bed was ballasted with Sherman gravel, and at the present time it is one of the best ballasted and easiest riding road-beds in the country.

During the two or three years after 1898 important changes of line were made. The line over the Black Hills between Cheyenne and Laramie which had a maximum grade of 90 feet to the mile, was relocated at a very heavy expense. A new line was constructed over the range which substituted a 43-foot grade for a 90-foot grade, and lowered the elevation of the summit of the Evans Pass at Sherman, Wyoming, from 8,243 feet to 8,011 feet above sea level.⁶⁸ In the construction of this line the great trestle at Dale Creek was done away with, and a fill of 800,000 cubic yards across the valley took its place. A new line was built over the Wahsatch Mountains, which involved the construction of the long tunnel known as the Aspen tunnel. By the construction of the new line 9 miles in distance were saved, a great deal of curvature was eliminated, and a dangerous piece of track was avoided, "which," says one of the company's officials, "had been prolific of many accidents."⁶⁹ In Wyoming, between Laramie and Rawlins, changes in location shortened the main line nearly 20 miles, reduced grades, and eliminated curvatures. Other changes in location were made west of Rawlins, which resulted in great economies in operation. A new line, the "Lane cut-off," was built between Omaha and Lane, Nebraska. This line followed to some extent the original location made by Dey in 1864, and avoided the circuitous route to the south, so that a saving of 10 miles in a distance of 22 was effected. In

⁶⁸ Annual Reports; Proc. Spec. Ex., p. 4298, testimony of Parks.

⁶⁹ Proc. Spec. Ex., p. 4298, testimony of Parks.

addition to reducing grades and eliminating curves, the total distance from Council Bluffs to Ogden was reduced from 1,038 miles to 1,003 miles.⁷⁰

The same policy was followed on the other Harriman lines. The Union Pacific advanced large sums to the Southern Pacific for the improvement of the Southern Pacific property. In 1904 these sums so advanced aggregated \$20,000,000.⁷¹ The Southern Pacific's earnings were large, but it paid no dividends during the five years from 1901 to 1906. Its surplus earnings remaining after fixed charges were paid were invested in permanent betterments and in new equipment. The most interesting single work of improvement upon the Harriman system is on the Southern Pacific line west of Ogden. This improvement is what is known as the Ogden-Lucin cut-off, from Ogden west across Great Salt Lake to Lucin, Utah. The old line to the north of the lake was not only roundabout, but it passed over the steep slopes of the Promontory Mountains. To shorten the distance and avoid the grades of the old lines, a new line was constructed from Ogden to Lucin, almost in an air-line. Two long trestles across the two northern arms of Great Salt Lake were built. One of these trestles is 10 miles, and the other 19 miles in length. In this way 44 miles in a distance of 144 miles were saved. Other extensive improvements were made upon the Southern Pacific, as well as upon the Oregon Short Line and the Oregon Railroad and Navigation Company.

In 1905 the management began the installation of the automatic electric block signal system. At the present time, and for some years past, the main lines of the combined system have been so protected. Other safety devices were adopted. Up to the beginning of the present year (1923) the greater part of the line from Omaha to Ogden had been double-tracked.

Between 1898 and 1903 over \$26,000,000 were expended

⁷⁰ See Annual Reports.

⁷¹ Annual Report for 1904, p. 10.



The Ogden-Lucin Cut-Off
Photo by Author

in improvements upon the Union Pacific proper, and nearly \$13,000,000 additional were expended upon the Oregon Short Line and Oregon Railroad and Navigation Company.⁷² During the same five years, the combined net earnings of these three roads increased nearly 100 per cent, or from \$13,051,478.16 in 1898, to \$22,327,972.87 in 1903. The great increase in the net earnings since 1900 the management attributed principally to the effect which these extensive improvements had upon the operation of the road.⁷³ The tonnage per car and per train almost doubled between 1898 and 1905. The average hauling capacity of each locomotive had increased so that it was 24.39 per cent greater in 1905 than it had been in 1898, and the average carrying capacity of the freight equipment increased by 13.84 per cent during the same seven years.⁷⁴ A great number of comparative statistics appear in the company's annual reports which indicate the marked benefits derived from the expenditures made in improving the road's physical condition.

The policy of investing surplus earnings in the property rather than in dividend distributions resulted eventually in bringing to the stockholders a very much greater return than would have been the case had a different policy been pursued. The management might have acted as many other railroad managements have. Instead of following the course which they did follow they might have sought to realize as large an immediate return as possible out of the road, regardless of the effect such policy might have upon its future solvency, or upon the community. A fair estimate of the Harriman management must recognize that in this respect its policy was wise and efficient, whatever view be taken in regard to other features of his unprecedentedly large railroad operations.

The principal developments in the history of the Union

⁷² Annual Reports. After the reorganization the fiscal year ended June 30, until 1916, when it was again made to correspond with the calendar year.

⁷³ Annual Report for 1905, p. 19.

⁷⁴ *Ibid.*, p. 19.

Pacific system from the time of the reorganization substantially down to 1905 have now been set forth. In tracing this development the chronological sequence of events has been disregarded at times, notwithstanding the fact that it has been adhered to so far as it seemed practicable to do so. The consideration of a number of important events during the first half of the decade from 1900 to 1910 has been postponed to the following chapter. In that chapter will be taken up the relations between the Union Pacific and the Atchison, Topeka and Santa Fé, and also the circumstances attending the construction of the new Los Angeles and Salt Lake line.

During the period from 1898 to 1905 the Union Pacific Railroad Company grew to be one of the strongest and most powerful railroad corporations in the United States. It had absorbed much of the railroad mileage of the west. Harriman, its president, who assumed that office in 1904 upon the resignation of Horace A. Burt, had become the dominant figure in the American railroad world.

CHAPTER XII

THE HARRIMAN SYSTEM

Profits from the Purchase of Northern Pacific Stock

The cost to the Union Pacific of the 781,080 shares of Northern Pacific stock which had been purchased in 1901 when Harriman attempted to add that road to his system had been about \$88,000,000. Under formal agreement between the Union Pacific and its subsidiary, the Oregon Short Line, this Northern Pacific stock had in May, 1901, been sold to the Oregon Short Line for the sum which it had cost the Union Pacific, \$88,334,545.01, so that title to these shares of Northern Pacific stock was vested in the Short Line company. The Oregon Short Line paid for this stock by issuing \$61,000,000 of purchase money certificates, which it delivered to the Union Pacific, these purchase money certificates being approximately equal in amount to the amount of convertible bonds used by the Union Pacific in purchasing the Northern Pacific stock. In addition to issuing these purchase money certificates the Oregon Short Line assumed short-time loans to the amount of \$27,500,000, which had been incurred by the Union Pacific in purchasing the Northern Pacific stock and which represented the difference between the \$61,000,000 of convertible bonds and the total cost of the Northern Pacific shares.¹

This Northern Pacific stock was subsequently, toward the close of the year 1901, turned into the Northern Securities Company, and in exchange the Oregon Short Line received 824,918.71 shares of Northern Securities Company stock, and a cash bonus of something over \$8,750,000.² The market

¹ Evidence before I. C. C., Proc. Spec. Ex., p. 257, testimony of William Mahl, complainant's exhibits 62 and 63.

² Meyer, History of the Northern Securities Case, p. 241.

value of these shares of Northern Securities Company stock added to this cash bonus exceeded by about \$1,250,000, 115 per cent of the par value of the 781,080 shares of Northern Pacific stock which the Oregon Short Line surrendered to the Northern Securities Company; so that, as B. H. Meyer points out, the ratio established as a basis for exchanging shares of Northern Pacific for Northern Securities Company stock was for some reason in this instance violated. The effect of this transaction had been to reduce to the Oregon Short Line the net cost of 824,918.17 shares of Northern Securities Company stock from \$88,334,545.01 to \$79,459,691.36.³

As a speculation the purchase of Northern Pacific stock resulted very profitably to the Union Pacific. In 1905, after the failure of Harriman's second attempt to get control of the Northern Pacific and the Burlington, the Northern Securities Company stock into which the original Northern Pacific stock had been converted in 1901 was in turn exchanged for Northern Pacific and Great Northern stock. The Oregon Short Line then received 281,828.82 shares of Northern Pacific, 216,520.89 shares of Great Northern, and 7,249 shares of Northern Securities Company "stubs."⁴

Subsequently the Great Northern issued some new preferred stock to which existing stockholders were permitted to subscribe at par; and the Oregon Short Line acquired under its subscription rights 37,444 shares, par value \$3,744,400, of new Great Northern stock. Thus the total cost of the Northern Pacific and Great Northern shares and Northern Securities Company stubs was \$83,204,091.36. The shares of Northern Pacific and Great Northern which the Oregon Short Line owned had no value for purposes of control, as the number of shares in each road which the Oregon Short Line held was only about 20 per cent of the total number of shares outstanding. They had value, however, as an invest-

³ Evidence before I. C. C., Proc. Spec. Ex., p. 256, testimony of Mahl, complainant's exhibit 62.

⁴ *Ibid.*, p. 257; Annual Report, 1907, p. 12.

ment, aside from the fact that they represented a certain "community of interest" between the Union Pacific and its two Northern competitors. During the latter part of 1905 and the early part of 1906 the market value of Great Northern and Northern Pacific became very high, so high that dividends upon the stocks of these two companies averaged only about 2.79 per cent of their market value.⁵ Under these circumstances the management of the Union Pacific concluded to sell its holdings. During the last half of the year 1906 the Union Pacific, or, to be more exact, the Oregon Short Line, disposed of a large amount of its holdings, at an average price of \$304.41 a share for Great Northern, and \$208.76 a share for Northern Pacific. These stocks were sold through Kuhn, Loeb and Company, and the fact that such very large sales were effected without depressing the stock market is cited by Mr. Kahn as an evidence of the ability and financial skill of the firm of which he was a member.⁶

The amounts which the Union Pacific realized out of its original investment in Northern Pacific stock are as follows:⁷

100,000 shares of Northern Securities Company sold before the dissolution of that company.....	\$16,880,019.46
163,600.89 shares of Great Northern.....	49,801,576.47
240,300.82 shares of Northern Pacific.....	50,116,357.97
.18 shares of Securities Company stubs.....	56.13

In addition, the Union Pacific had acquired by virtue of its holdings in the Great Northern, its proportionate share of Great Northern ore certificates. Of these ore certificates 13,200 were disposed of by the Union Pacific, and \$1,021,789.63 received for them. Thus the total sum realized from the sale of all these securities amounted to \$117,869,799.66, or \$34,665,708.30 in excess of \$83,204,091.36 which the total investment had cost the Oregon Short Line. Moreover, there remained unsold in the treasury of the Oregon Short Line on

⁵ Annual Report, 1907, p. 12.

⁶ Evidence before I. C. C., Proc. Spec. Ex., p. 1235, testimony of Kahn.

⁷ Annual Report, 1907, p. 12.

June 29, 1907, stocks of the two Northern companies, the Great Northern and Northern Pacific. The market value of these stocks still remaining on hand amounted at that time to about \$22,000,000.⁸

Purchase of Stocks of Other Railroads

The success of this speculation furnished the Union Pacific with large additional resources, which were now used under the direction of Harriman in purchasing shares of stock in other railroads. The Interstate Commerce Commission reported in 1907:

In practically all the great transactions of this company, Mr. Harriman, as chairman of the Executive Committee, acted upon his own initiative, and his acts were subsequently ratified and approved by the Executive Committee. It may fairly be said therefore, that the policies and purposes of the Union Pacific have been those of Mr. Harriman.⁹

Already in 1904 the Union Pacific had purchased 103,431 shares of 4 per cent non-cumulative preferred stock of the Chicago and Alton road. These shares, which represented about one-third of that company's total outstanding stock, preferred and common, were acquired at \$86.50 a share, from a syndicate which had recently purchased and reorganized the road.¹⁰ In the fall of 1904, the control of the Alton passed from this syndicate to the Chicago, Rock Island and Pacific Company, and a contract for the joint control of the Alton was made between individuals representing the Union Pacific, and individuals representing the Rock Island, under which agreement the Union Pacific was each alternative year to have a majority of the Alton directors and the Rock Island a minority, and each other alternative year the Rock Island was to have a majority and the Union Pacific a minority. This arrangement was maintained until 1907, when for some

⁸ Annual Report, 1907, p. 12.

⁹ 12 I. C. C. Rep., 320.

¹⁰ The members of this syndicate were Harriman, George Gould, Jacob Schiff, and James Stillman.

reason it was terminated. The Union Pacific, however, still retained its shares of this preferred stock.¹¹

During the last six months of 1906 the enormous sum realized from the sale of Great Northern and Northern Pacific stock was reinvested in "high-class" railroad stocks, which paid annual dividends of from 4 to 5 per cent upon their cost, and also gave the Union Pacific, as a large stockholder, an influential voice in the councils of these other lines.¹² In addition to the company's stock interest in the Chicago and Alton, the Union Pacific, or the Oregon Short Line, between June 30, 1906, and the close of the same year, acquired the following stockholdings in other companies:¹³

Name of Road	Par Value Amount Purchased	Per Cent of Issue	Per Cent of Preferred and Common Combined
Atchison, Topeka and Santa Fé			
Preferred	\$10,000,000	7.61	4.28
Baltimore and Ohio			
Preferred	7,206,400	21.23	18.62
Common	32,334,200	12.01	
Chicago, Milwaukee & St. Paul			
Common	3,690,000	6.34	3.42
Chicago and Northwestern			
Common	2,572,000	3.32	2.58
Illinois Central	28,123,100	29.59	29.59
New York Central and Hudson River....	14,285,745	7.97	7.97
St. Joseph and Grand Island			
1st Preferred	932,200	16.95	37.37
2nd Preferred	1,250,000	37.71	
Common	2,900,000	63.04	

In this list the St. Joseph and Grand Island road appears. This road which had been one of the auxiliary lines of the old system, again came within the control of the Union Pacific, although it continued to be independently operated. It had been reorganized and was now paying dividends. Its stock had been purchased from Harriman at a cost to the Union Pacific of a little over \$2,000,000.¹⁴

Of the Illinois Central stock which was acquired by the

¹¹ ¹² I. C. C. Rep., 344.

¹² Proc. Spec. Ex., p. 4722, testimony of Kahn.

¹³ ¹² I. C. C. Rep., 336; testimony of Mahl before I. C. C.

¹⁴ ¹² I. C. C. Rep., 337. How much this stock had cost him, Harriman refused to disclose.

Union Pacific, 186,231 shares were purchased directly through Kuhn, Loeb and Company, at \$175 a share.¹⁵ The Railroad Securities Company, a corporation controlled by Harriman, owned the other 95,000 shares. The Union Pacific purchased Harriman's stock in the latter company; so that including the Illinois Central shares which it acquired in its own name and the shares which it held through the Railroad Securities Company, the Union Pacific controlled nearly 30 per cent of the stock of the Illinois Central.¹⁶ The Union Pacific acquired, therefore, practically a dominating influence in this road, although the management and operations of these two companies were not united as in the case of the Union Pacific and the Southern Pacific.

Harriman and Stuyvesant Fish, the president of the Illinois Central, did not agree in reference to the management of that road. One consequence of Harriman's control was the forced retirement, in 1906, of Fish from the presidency of the Illinois Central after a dispute between the two men which received national notoriety.

In these various transactions whereby the Union Pacific purchased millions of dollars of stock of other railroad companies, with the result that it extended its control over the Illinois Central and the St. Joseph and Grand Island, and secured an influential "community of interest" representation in such important companies as the New York Central, the Baltimore and Ohio, and the Santa Fé, Harriman, so it appears from the evidence at hand, acted entirely on his own initiative.

Manner of Financing Stock Purchases

An outline of the effect of these enormous stock transactions upon the capitalization of the Union Pacific is necessary to a full understanding of their significance. The convertible bonds issued in 1901 had furnished the greater part of the

¹⁵ Evidence before I. C. C., Proc. Spec. Ex., p. 746, testimony of E. H. Harriman.

¹⁶ Evidence before I. C. C., testimony of William Mahl.

resources with which the stocks of the Northern Pacific and Southern Pacific had been purchased. The combined cost of the Union Pacific's acquisition in these two roads did, however, exceed the proceeds of this bond issue by over \$27,000,000. For a time this sum was carried as a floating debt; but in July, 1902, the Oregon Short Line authorized an issue of \$82,491,000 of 4 per cent and participating gold bonds.¹⁷ Thirty-one millions were issued at once and five millions more were issued six months later.¹⁸

These bonds were secured by a pledge of the Union Pacific's Northern Securities Company stock, ten shares being pledged to secure each bond of \$1,000. The series was underwritten, as usual, through Kuhn, Loeb and Company, and was floated at 90 cents on the dollar. Interest was to be at 4 per cent per annum, but if the collateral underlying these bonds should receive greater dividends than 4 per cent, the amount in excess of 4 per cent was to be paid to holders of these bonds. The bonds were to run for twenty-five years, and be redeemable at the company's option at any time before maturity, at a premium of $2\frac{1}{2}$ per cent. The proceeds of this issue enabled the Oregon Short Line to retire a very considerable portion of a large gross floating debt, which had been incurred not only in the purchase of the Northern Pacific stock, but also through the Union Pacific's construction advances to the Southern Pacific.¹⁹

The financial strength of the Union Pacific was now ample, and it found no difficulty in carrying what would seem at first glance to have been an excessive floating debt. Its advances to the Southern Pacific were, moreover, real assets. They would eventually be repaid, and in the meantime bore interest. Quotations of Union Pacific common shares advanced steadily, and it soon became desirable for holders of

¹⁷ Evidence before I. C. C., Proc. Spec. Ex., p. 265, testimony of Mahl, complainant's exhibit 70; p. 84, correspondence between Kuhn, Loeb and Company and E. H. Harriman, complainant's exhibit, 29.

¹⁸ *Ibid.*

¹⁹ Annual Report for 1903.

the convertible bonds issued in 1901 to exercise their privilege of converting them into shares of common stock. As the bonds were converted, corresponding amounts of the collateral securing them were released.²⁰

By 1905 the greater part of the convertible bonds had been converted. Early in the same year the Oregon Short Line authorized the issue of a new series of \$100,000,000, 4 per cent refunding 25-year gold bonds.²¹ Forty-five millions were sold through Kuhn, Loeb and Company, and the balance retained in the Union Pacific treasury. This series was secured by a pledge of as much of the Southern Pacific stock as was released by the conversion of the convertible bonds, and also by a pledge of the preferred and common stock of the Oregon Railroad and Navigation Company, and by a pledge of 5,000 shares of Northern Securities Company "stubs," of which the Oregon Short Line was the owner.²² Part of the proceeds of this new bond issue was used by the Oregon Short Line to retire its outstanding "4 per cent and participating" bonds, and part was used in subscribing under its subscription rights to \$18,000,000 of a new issue of Southern Pacific 7 per cent preferred stock.²³ It was out of the proceeds of this stock that the Southern Pacific repaid to the Union Pacific the sums which the latter company had advanced to aid its reconstructive work.

The authorized capital stock of the Union Pacific at the time when it had purchased the Southern Pacific had amounted to \$196,178,700. Of this amount \$100,000,000 were preferred, and \$96,178,700 were common. At the time of reorganization \$61,000,000 of common stock and \$75,000,000 of preferred had been issued, and the remainder, both preferred and common, had been issued in acquiring the Oregon Short Line, and the Oregon Railroad and Navigation Company.

²⁰ In 1907 the entire issue of \$100,000,000 had been converted into stock. (Annual Report for 1907.)

²¹ Annual Report for 1905.

²² Evidence before I. C. C., Proc. Spec. Ex., p. 264, testimony of Mahl, complainant's exhibit 68.

²³ Annual Report for 1905.

After the convertible 4 per cent bonds issued in 1901 had all been retired by conversion, the common stock had been increased by \$100,000,000. Since 1901 the funded debt outstanding of the Union Pacific system had been increased by \$45,000,000 when a corresponding amount of Oregon Short Line refunding bonds had been issued. The acquisition by the Union Pacific of its stock interests in other companies had therefore the following net result upon the entire capitalization of the Union Pacific system (not including the stock issued to acquire the Oregon Short Line and the Oregon Railroad and Navigation Company) :

Common stock increased by conversion of 4% convertible bonds.	\$100,000,000
Oregon Short Line refunding bonds.....	45,000,000
<hr/>	
Total increase in capital obligations, representing stock of other railroads owned by Union Pacific.....	\$145,000,000
<hr/>	

In addition the Union Pacific Railroad Company in September, 1906, gave its notes to Kuhn, Loeb and Company for \$36,393,432, which represented a part of the cost of the Baltimore and Ohio stock. In consequence therefore of its stock investment, the Union Pacific and its subsidiary, the Oregon Short Line, had assumed capital and floating obligations which together, at the close of the year 1906, amounted in round numbers to about \$181,000,000.²⁴ While this figure is necessarily only an approximation, it indicates with sufficient accuracy, the net cost of the Union Pacific's purchases of railroad stocks.

Over against these obligations, the company was the owner of stocks the cost of which had aggregated over \$130,000,000, without including either the Southern Pacific stock, or the stock of the Great Northern and Northern Pacific, which the Union Pacific still owned. The shares of the Southern Pacific which were owned by the Union Pacific had a market value of about \$50,000,000. The Great Northern and Northern Pacific

²⁴ 12 I. C. C. Rep., 333.

stock in the Union Pacific treasury in the early spring of 1907 was estimated by Harriman to be worth in the neighborhood of \$30,000,000.²⁵ As a partial offset of what appears an enormous floating debt, the Union Pacific held in 1907, "demand loans" aggregating \$3,050,000.00, and \$7,520,848.64 in cash; while for the fiscal year ending June 30, 1907, the Union Pacific had a surplus over fixed charges and dividends which amounted to \$10,687,882.85.²⁶

As railroad securities have a tendency to fluctuate more or less, a financial policy on the part of a railroad management of issuing stock or bonds which represent investments in the stocks of other railroads may be open to serious question, as to its soundness, aside from all considerations of the advisability or inadvisability of maintaining the "freedom of competition," or the effect which such stock investments may have as tending to "restrain trade." In 1907 the Interstate Commerce Commission reported, in regard to these Union Pacific acquisitions, "it therefore adds an element of hazard to a railroad's capital and credit to have its funds invested in the stocks of other companies, thereby endangering its solvency and its ability to pay reasonable dividends upon its own capital stock."²⁷ However, as it happened in the case of the Union Pacific, these stock speculations had a very satisfactory result from the standpoint of the company and its security-holders.

Senator Clark's Proposed New Railroad

It is now necessary to go back several years to the beginning of the decade from 1900 to 1910, in order to take up the history of the construction of the San Pedro, Los Angeles and Salt Lake Railroad, or as it is now known, the Los Angeles, and Salt Lake Railroad. It will be remembered that the old

²⁵ Evidence before I. C. C., Proc. Spec. Ex., p. 748, testimony of E. H. Harriman.

²⁶ Annual Report for 1907. On June 30, 1907, there were outstanding \$69,050,220 of loans and bills payable, representing the cost of reconstructional work, and of stock acquisitions in other lines. "To provide funds for paying off current liabilities, for equipment to be delivered, for improvements and construction under way, and for other corporate purposes," an issue of new convertible bonds not exceeding \$75,000,000 was authorized in 1907. These bonds were made convertible into common stock at 175.

²⁷ 12 I. C. C. Rep., 347.

Utah Central Railway from Ogden to Frisco, Utah, which had been built in the seventies, had in 1889 been included in the Oregon Short Line and Utah Northern consolidation. The Adams administration had at one time contemplated extending to Los Angeles this branch of the Oregon Short Line and Utah Northern Railway, and with this end in view, the company had made some surveys in 1889 and 1890. A right of way through the public lands was secured from the United States Land Office, and some grading had been done in a southwesterly direction from Milford, Utah, a station near Frisco, but when financial difficulties began to weigh heavily upon the old system, toward the close of 1890, it was necessary to abandon construction of this road.

On August 20, 1898, a group of western capitalists organized, under the laws of Utah, a corporation known as the Utah and Pacific Railroad Company, for the purpose of constructing a railroad from Milford, Utah, to the Utah-Nevada state line.²⁸ Four days prior to the incorporation of this company the incorporators had made an agreement with the Oregon Short Line Railroad Company whereby the latter company assigned to the proposed Utah and Pacific Railroad Company its rights in the Oregon Short Line and Utah Northern Railway grade extending southwesterly from Milford, and also agreed to sell to the new company second-hand rails to be used in the construction of the road.²⁹ Under this contract the Oregon Short Line received a five-year option to purchase the Utah and Pacific road, at prices and upon terms and conditions which were specified in the contract. The Utah and Pacific Company constructed a road along the old right of way of the Oregon Short Line and Utah Northern Railway from Milford, Utah, to Uvada, a station on the Utah-Nevada state line. On February 2, 1899, the Utah, Nevada and California Railroad Company was organized under the laws of the

²⁸ Copy of articles of association is in Proc. Spec. Ex., p. 4776, defendant's exhibit 238.

²⁹ Copy of agreement is in Proc. Spec. Ex., p. 2436.

state of Nevada, as a subsidiary corporation of the Oregon Short Line, for the purpose of continuing the Utah and Pacific line from Uvada across Nevada toward California;³⁰ but this projected road southwest of Uvada was not built, the work being indefinitely postponed, if not altogether abandoned.

Such was the situation in the winter of 1900 to 1901. The Oregon Short Line owned the road from Salt Lake City to Milford, with a branch to Frisco; the Utah and Pacific Railroad owned the link from Milford to Uvada, subject to the option which the Oregon Short Line held; while the Oregon Short Line controlled a moribund company, the Utah, Nevada and California Railroad, which had been organized to continue the work southwest of Uvada. In the fall of 1900, a number of capitalists, headed by Senator William A. Clark of Montana, who were interested in a local California line, the Los Angeles Terminal Railway, announced their intention of building a road from Los Angeles to Salt Lake City. The purpose of these men took definite shape when on March 21, 1901, Senator Clark and his associates filed articles incorporating under the laws of Utah the San Pedro, Los Angeles and Salt Lake Railroad Company, to build a line of railroad between Salt Lake City and Los Angeles.³¹ It was the declared intention of the incorporators that this road, when constructed, should be independent of any other company, except in so far as it might have occasion to enter into traffic contracts with the Union Pacific, the Denver and Rio Grande, or any other of its connections.³²

The grading done by the Oregon Short Line Company from Uvada southwest had been apparently abandoned.³³ A portion of the right of way extending from Uvada, on the Utah-Nevada state line, to a place then known as Clover Valley Junction, now the town of Caliente, and thence to a

³⁰ Copy of agreement of association is in Proc. Spec. Ex., p. 4788, defendant's exhibit 240.

³¹ Copy of articles of association is in Proc. Spec. Ex., p. 3405, complainant's exhibit 203.

³² Evidence before I. C. C., Proc. Spec. Ex., p. 607, testimony of J. Ross Clark.

³³ *Ibid.*, p. 606.

point within 3 miles of the town of Pioche, Nevada, had, in 1894, been exposed for sale for delinquent taxes, and sold to Lincoln County, Nevada.³⁴ The Clark interests had in the fall of 1900, several months prior to the formal organization of the San Pedro, Los Angeles and Salt Lake Railroad, obtained control of an already existing but at that time apparently no longer active corporation, the Utah and California Railway Company.³⁵ This company on March 4, 1901, purchased the tax title to the graded right of way extending across the desert from Uvada to Caliente, and thence toward Pioche.³⁶ The same company had already, some years previously, made surveys along the same route, and had asked that its maps be approved by the Interior Department, but this approval was never obtained.³⁷ On April 19, 1901, the Utah and California Company conveyed and quitclaimed to the San Pedro Company its rights in this right of way.³⁸ The Clark people also commenced a survey from Caliente southwest through a canyon known as the Meadow Valley Wash. They believed that the old right of way of the Short Line had been permanently abandoned.

Struggle between Clark and Harriman Interests

The activity of this projected rival line at once attracted the unfavorable attention of the Union Pacific-Southern Pacific system. The Harriman management was naturally ill disposed to see the construction of a line which would compete with the Southern Pacific for the business between Utah and California, and one which might, in connection with the Denver and Rio Grande, become a competitor for eastern transcontinental traffic. The Union Pacific interests lost no time in taking steps to protect themselves from the competition of this

³⁴ Proc. Spec. Ex., p. 3209, complainant's exhibit 172.

³⁵ *Ibid.*, p. 4793, testimony of William R. Kelly.

³⁶ *Ibid.*, p. 4796.

³⁷ *Ibid.*, p. 3270 (copy of Findings of Fact, Decision of Secretary of Interior, *Utah, Nevada and California Railroad Company v. Utah and California Railway Company*).

³⁸ *Ibid.*, p. 4793, testimony of W. R. Kelly.

new road. Clark's purpose had been announced in the early fall of 1900.³⁹ After it had become a matter of public notoriety that the new road was to be built, the Union Pacific interests obtained, by exercising the Oregon Short Line's option on the Utah and Pacific road, the control of the line from Milford to Uvada, and openly asserted their claim to the right of way leading southwest of Uvada.⁴⁰ Litigation soon resulted, early in 1901, between the Utah, Nevada and California Railroad Company and the Utah and California Railway Company, the object of the Short Line's subsidiary being to prevent the San Pedro road from acquiring the right of way.

The 40 miles from Uvada to Caliente, as well as the branch from Caliente to Pioche, had been graded by the old Oregon Short Line and Utah Northern Railway. From Caliente southwest through the Meadow Valley Wash canyon surveys had been made by this company, in 1889 and 1890, and maps had been filed, but no further work had been done, and in 1900 the canyon was lying unoccupied.⁴¹ Although the maps of the Utah and California Company, covering the already graded part of the route from Uvada southwest, had never been approved by the Land Office, that company urged their acceptance on the ground that, as the right of way had been abandoned by the Short Line, the title had lapsed, and that the line was therefore open to occupancy by any other company which should desire to make use of it. The dispute between the Utah and California Company and the Utah, Nevada and California Company over the portion of the right of way between Uvada and Caliente, being the already graded part of the road, came before the United States Land Office at Carson City, and was decided in favor of the Clark interests.⁴² The question was, however, appealed to the Secretary of the Interior, who reversed the decision of the Land Office and decided in favor of

³⁹ *Salt Lake Tribune*, Sept. 17, 1900.

⁴⁰ Proc. Spec. Ex., p. 2433, testimony of David Eccles.

⁴¹ *Ibid.*, p. 3236, testimony of Charles Whittemore; evidence before I. C. C., Proc. Spec. Ex., p. 682, testimony of T. E. Gibbon.

⁴² Proc. Spec. Ex., p. 3267, copy of decision of Land Office.

the validity of the claim of the Oregon Short Line's subsidiary, the Utah, Nevada and California Company, to this part of the route.⁴³ The Harriman interests, represented by the Oregon Short Line, also contended that Clark's company, the Utah and California, was without legal power under its charter, to acquire a right of way for the construction of a railroad in the state of Nevada,⁴⁴ and claimed therefore that the purchase by that company of tax titles to the disputed grade was invalid. The validity of the tax titles was also attacked on the ground of fraud.

The decision of the Secretary of the Interior upholding the claim of the Utah, Nevada and California Company was rendered on April 24, 1901; but the rights which the Clark people claimed under their tax title remained undecided. This question was put in litigation in one of the state courts of Nevada.⁴⁵ In the meantime both parties had their construction gangs in the field. The Oregon Short Line forces went right ahead laying their track on the graded line southwest of Uvada, while the Clark people did what they could to hinder them in their work by setting up upon the grade barricades of various sorts, such as stumps, logs, and barbed wire fences.⁴⁶ The Oregon Short Line advanced notwithstanding, until its tracks were laid as far as Caliente, at the entrance of the canyon of the Meadow Valley Wash.⁴⁷ This canyon appears to have been a "strategic position." While it was possible to build a road through to California without passing through it, it appears that it was not practicable to do so. No grading or any other work had been done in this canyon by the old Oregon Short Line and Utah Northern Company, except to make a survey through it, and the prior right of way would belong to the party which should first file its map with the land office.

⁴³ *Ibid.*, p. 3269, copy of decision of Secretary of Interior.

⁴⁴ Pleadings in suit of *Utah, Nevada and California Railroad Company v. Utah and California Railway Company*, No. 709 U. S. C. C., 9th Circuit, District of Nevada, reprinted in Proc. Spec. Ex., pp. 3149 ff., complainant's exhibits 170-5.

⁴⁵ Proc. Spec. Ex., p. 4799, testimony of W. R. Kelly.

⁴⁶ *Ibid.*, p. 3147, testimony of Whittemore; p. 2582, testimony of Charles D. Moore.

⁴⁷ Evidence before I. C. C., Proc. Spec. Ex., p. 682, testimony of T. E. Gibbon.

The San Pedro people had been first on the ground, and had already commenced a survey through the canyon in the spring of 1901; but before their survey had progressed very far their surveying party was met and overtaken by surveyors of the Oregon Short Line, who completed their work ahead of the San Pedro surveyors.⁴⁸ This survey of the Oregon Short Line seems to have been made with astonishing rapidity, and there was some question as to whether or not it was bona fide; but the Oregon Short Line people subsequently explained their ability to proceed so rapidly by the fact that they were following their old surveys and field notes which had been made in 1890. Their map was filed first, the Clark people immediately protesting against its acceptance.⁴⁹ In the meantime trouble arose between the two construction forces in the field. Some shooting is said to have occurred, but it seems no one was injured. The San Pedro people erected barricades at the head of the canyon, to prevent the Oregon Short Line construction forces from advancing south of Caliente; while at the same time San Pedro gangs were at work farther down the canyon.⁵⁰

A large amount of litigation in both the federal and state courts resulted from the attempt of each of these two rival roads to secure the right of way. On April 27, 1901, the federal circuit court had issued an injunction restraining the San Pedro company from hindering the construction of the Oregon Short Line between Uvada and Caliente,⁵¹ and in August of the same year the Clark people obtained an injunction from the same court, restraining their opponents from entering upon the right of way of the San Pedro road south of Caliente, pending the settlement of the disputed title to the right of way through the canyon.⁵² This question of title was,

⁴⁸ Proc. Spec. Ex., pp. 3262, 3263, testimony of Charles Whittemore.

⁴⁹ *Ibid.*

⁵⁰ Evidence before I. C. C., Proc. Spec. Ex., p. 683, testimony of Gibbon; Proc. Spec. Ex., p. 2582, testimony of Charles D. Moore.

⁵¹ *Utah, Nevada and California Railroad Company v. Utah and California Railway Company*, 110 Fed. 879; Proc. Spec. Ex., p. 3231, complainant's exhibit 175A.

⁵² Proc. Spec. Ex., p. 3233, complainant's exhibit 175C.

however, never determined, for eventually negotiations opened between the counsel for the opposing parties, which resulted in an agreement for a joint survey of two parallel lines through the canyon, which were to be so located that neither line would cross the other. A stipulation to this effect was drawn up in September, 1901.⁵³

Completion of the Salt Lake Line

This joint survey was undertaken, but the arrangement was mutually unsatisfactory. The compromise contemplated the construction of two parallel routes from Salt Lake City to Los Angeles. The construction of two lines through the canyon so that they would not cross and recross one another would have added greatly to the cost of each. While the San Pedro Company had not succeeded in acquiring the already constructed grade from Caliente to Uvada, or the grade from Caliente to Pioche, which offered an alternative route for a through line, there was of course nothing to prevent it from building through from Los Angeles to Salt Lake City; but the possession of the grade from Caliente north would have been of great value to the Clark interests, if their original plan was to be carried out.⁵⁴ For the construction of two parallel lines between Salt Lake City and Los Angeles there was no economic justification. Throughout the greater part of the distance, the country along the line is an uninhabited desert, which could hardly furnish enough local traffic to sustain even one road. A railway between these two cities would not be likely to succeed unless it were operated harmoniously with its connections at each end. With the Southern Pacific in substantial control of the situation in California, and the Union Pacific in substantial control of the situation from Utah east, a road competing with a line owned by the Harriman interests was not likely to prove a good financial venture. Senator Clark and

⁵³ Evidence before I. C. C., Proc. Spec. Ex., p. 684, testimony of T. E. Gibbon. For copy of stipulation see Proc. Spec. Ex., p. 4801.

⁵⁴ Proc. Spec. Ex., p. 2575, testimony of Thomas Kearns.

his associates finally realized the hopelessness of carrying on a successful fight against the Harriman roads and entered into negotiations to obtain better terms.⁵⁵

Conferences were held frequently during the winter of 1901 and 1902 between the representatives of both sides, and, after much negotiation, a contract was finally agreed to between the parties. By the terms of this contract, which was dated July 7, 1902, the Harriman interests were to receive an undivided one-half interest in the San Pedro road, while the Oregon Short Line agreed to convey to the San Pedro Company all its lines which extended south of Salt Lake City.⁵⁶ Under a subsequent contract which bore the date of June 7, 1903, between Harriman, Clark, and the Farmers' Loan and Trust Company of New York, the trust company was to hold the stock of the San Pedro Company as trustee. Clark, as trustee, and Harriman, as trustee, each were to receive from the trust company certificates of interest for their respective shareholdings, and these two men were to select the board of directors; but if they failed to agree, each was to nominate one-half of the board.⁵⁷ Under the joint control thus established by these contracts, the construction of the new line proceeded without further interruption, and in the spring of 1905 the San Pedro, Los Angeles and Salt Lake Railroad was opened for business.

Senator Clark's attempt to build an independent line between Los Angeles and Salt Lake City ended therefore in a combination of his road with the Harriman system. The same man who became the first vice-president of the San Pedro Company, W. H. Bancroft of Salt Lake City, was also the general manager of the Oregon Short Line system and of the Union Pacific lines east from Ogden to Green River, and of the Southern Pacific lines west from Ogden to Sparks, Ne-

⁵⁵ Proc. Spec. Ex., p. 2575; also p. 4805, testimony of Kelly.

⁵⁶ *Ibid.*, p. 86, complainant's exhibit 30.

⁵⁷ *Ibid.*, p. 109, complainant's exhibit 31. The total stock issue of the San Pedro Company was \$25,000,000, of which one-half now belonged to the Oregon Short Line and the other half to Clark and his associates, except the qualifying shares issued to the directors.

vada.⁵⁸ The significance of the history of the construction of this new line is apparent. The dispute between the Clark and Harriman interests over the grade between Uvada and Caliente involved delicate questions of law, into the details of which it would not be profitable to enter in this work. But whatever may have been the legal rights of the Oregon Short Line to the grade south of Uvada, the Union Pacific system made no move toward the construction of a line along that route through to California until after September, 1900, when Senator Clark's intentions had become generally known. To prevent this rival interest from invading its monopoly of the traffic between Utah and California, the Union Pacific-Southern Pacific system adopted a course which finally compelled the San Pedro Company, if it wished to escape failure as a business enterprise, to amalgamate with the Union Pacific.

Relations with the Santa Fé

A glance at a map of western railroads as they existed in the first half of the decade from 1900 to 1910 will show that while traffic might have been routed over any one of several lines east of the meridian of Denver, there was no way in which it might be shipped by rail to California without passing for at least some part of the distance over the Harriman system, or the Atchison, Topeka and Santa Fé system. Of the three overland transcontinental routes to California those via Ogden, via Albuquerque, and via El Paso, the Union Pacific-Southern Pacific system controlled two, the routes via Ogden and via El Paso. The same system controlled the only all-rail route from Portland, on the north, and also the regular water lines from Portland to California and from Panama to California. The water route of the American-Hawaiian line from the east to California via the Isthmus of Tehuantepec, was not a part of the Harriman system, nor was the only other transcontinental rail route to California, the Atchison, Topeka

⁵⁸ Evidence before I. C. C., Proc. Spec. Ex., p. 644, testimony of J. Ross Clark.

and Santa Fé. This Santa Fé road had the facilities and was able to offer to shippers and travelers a high quality of service which enabled it to compete successfully with the Harriman lines for the traffic, both freight and passenger, of both northern and southern California.

The Santa Fé Company in 1901 purchased the Santa Fé, Prescott and Phoenix Railway, which extended from Ash Fork, Arizona, to Phoenix, Arizona. The president of this company, Frank L. Murphy, of Arizona, was retained in office after the Santa Fé system bought the line. At the time the purchase was made, Murphy had been interested in a project to build a new railroad southeast from Phoenix to Benson, Arizona, a point on the Sunset Route of the Southern Pacific.⁵⁹ Although this Mr. Murphy, who was characterized by Victor Morawetz of the Santa Fé Company as an "enthusiastic son of Arizona,"⁶⁰ was very eager to have this road built, and although he firmly believed that it would prove a financial success, his suggestion, it appears, did not commend itself strongly as a financial proposition to the Santa Fé management. At Murphy's urgent insistence, however, the Santa Fé Company finally concluded to build the road from Phoenix east for about 96 miles to a place in Arizona called Dudleyville, but to defer for a time the construction of the remaining portion of the line from that place to Benson.⁶¹ The route of the line from Phoenix to Dudleyville is somewhat to the south of the recently completed Roosevelt Dam, by means of which a large area of Arizona had been reclaimed for agricultural purposes. Work on this new line, which was known as the Phoenix and Eastern, was commenced early in 1902, and the road was completed to Dudleyville by the fall of 1904.⁶²

While the Santa Fé interests, as it appears from the evidence, were not enthusiastic about the possibilities of this

⁵⁹ Proc. Spec. Ex., p. 1133, testimony of Victor Morawetz.

⁶⁰ *Ibid.*, p. 1139, testimony of Morawetz.

⁶¹ *Ibid.*, pp. 1133 ff., testimony of Morawetz.

⁶² *Ibid.*, p. 1020, testimony of Frank L. Murphy.

branch, or eager to continue with its extension to Benson, its construction was not looked upon with favor by the Southern Pacific. As a local road the Southern Pacific regarded it as an invasion of its territory, while if it should be extended to Benson, competitive conditions would result with respect to through business. From Benson east to El Paso the El Paso and Southwestern system, an independent road, parallels the Southern Pacific, and east of El Paso the El Paso and Southwestern had an outlet over the tracks of the Rock Island system and of the Texas and Pacific road, the last two named roads being competitors of the Southern Pacific lines east of El Paso. West of Phoenix, the Santa Fé in or about 1903 commenced to build a cut-off, which has since been completed, from Phoenix to a station on the main line of the Santa Fé named Bengal, somewhat west of the boundary between Arizona and California.⁶³ The El Paso and Southwestern was willing and anxious to enter into a traffic agreement with the proposed Phoenix and Eastern line to Benson, and if the link from Dudleyville to Benson should be built by the Santa Fé, the route via the El Paso and Southwestern to Benson, and thence via the Santa Fé's Phoenix and Eastern line to Phoenix, and from Phoenix to California over the Santa Fe's new cut-off, would offer a new transcontinental line which threatened to become a competitor of the Southern Pacific's Sunset Route.⁶⁴

About the same time, in 1902 or 1903, the Harriman interests were seeking to extend their control over some local lines in northern California. In 1902 the Southern Pacific purchased the stock of the California and Northwestern Railroad, a system which extended for about 150 miles northwest of San Francisco. In the same year the Santa Fé bought the Eel River and Eureka Railroad, which included a system of

⁶³ *Ibid.*, pp. 1167 ff., testimony of James Douglas; copies of correspondence, pp. 1171-94.

⁶⁴ Proc. Spec. Ex., pp. 1144-47, testimony of Morawetz, pp. 1017-19, testimony of Murphy.

several short branches, all radiating east or southeast from the town of Eureka, in Humboldt County, California, into a heavily timbered region. Between these two systems, the one controlled by the Santa Fé and the other controlled by the Southern Pacific, there was a gap of some 40 or 50 miles. Each company was making surveys and planning to build into the territory of the other, the Southern Pacific seeking access to the redwood forests in the north, and the Santa Fé desiring a rail connection with San Francisco.⁶⁵ Railroad construction and operation in this region is expensive, as the country is difficult in character, and the construction of two parallel lines from San Francisco to Eureka might be an unprofitable investment for both roads.

About 1902 or 1903 negotiations commenced between the Santa Fé and the Southern Pacific for the settlement of the differences between the two companies over the situation in Arizona and in northern California. Harriman, it seems, resented keenly the Phoenix and Eastern's invasion of the Southern Pacific's territory, and in order to forestall its potential competition as part of a through line from El Paso to California, he attempted to buy it for the Southern Pacific.⁶⁶ The Santa Fé people, while apparently willing enough to sell this branch, insisted that a settlement of the more important northern California situation be made at the same time. As a condition precedent to selling the Phoenix and Eastern, the Santa Fé demanded an equal half-interest in the proposed through line from San Francisco to the forests in northern California, near Eureka.⁶⁷

Harriman was unwilling to accord the Santa Fé people the interest they demanded in the California road. While the dispute was going on, the Santa Fé, perhaps as a measure of compulsion, projected an extension of the Phoenix and

⁶⁵ Proc. Spec. Ex., p. 1134, testimony of Morawetz; evidence before I. C. C., Proc. Spec. Ex., p. 525, testimony of A. H. Payson.

⁶⁶ Proc. Spec. Ex., p. 1134, testimony of Morawetz.

⁶⁷ *Ibid.*

Eastern line from Dudleyville east through the canyon of the Gila River, to Deming, New Mexico, a point on the Southern Pacific, and also the terminus of a branch of the Santa Fé.⁶⁸ It is probable that the Santa Fé did not intend to construct this line immediately,⁶⁹ but its activity in making surveys along the canyon of the Gila River was disturbing to the Southern Pacific. A through line from Deming to Phoenix via the Gila Canyon would give the Santa Fé an alternative low-grade through route from El Paso to Phoenix and from Phoenix west to California, which might divert to the Santa Fé a large amount of business from the Southern Pacific main line west of El Paso. To forestall any such situation, a subsidiary of the Southern Pacific Company, the Arizona and Eastern Railroad, projected a road from the Southern Pacific main line northwest toward Phoenix through the Gila Canyon, where, it seems, lay the most practicable route for a through line between Phoenix and Deming. Both sides were desirous of getting possession of this canyon, and a struggle took place for the right of way through it. Some difficulties even occurred between the field forces of the rival companies.⁷⁰ As usual the courts were called upon to decide what were the rights of each company, and after some litigation, the Phoenix and Eastern people eventually succeeded in obtaining the legal title to the right of way through the Gila Canyon.⁷¹

This dispute over the Gila Canyon took place in 1904. A compromise was finally reached whereby the Santa Fé agreed to sell the Phoenix and Eastern road to the Southern Pacific,⁷² while the Harriman interests acceded to the Santa Fé's request for a half-interest in the northern California lines. It was arranged that the Eel River and Eureka road, which the Santa Fé owned, and the California and Northwestern, which the Southern Pacific owned, were to be consolidated into a new

⁶⁸ Proc. Spec. Ex., pp. 1136 ff., testimony of Morawetz.

⁶⁹ *Ibid.*, p. 1135, testimony of Morawetz.

⁷⁰ *Ibid.*, p. 1025, testimony of Murphy.

⁷¹ *Ibid.*

⁷² *Ibid.*, p. 974, complainant's exhibit 104.

company to be known as the Northwestern Pacific Railroad Company, this company to be managed jointly by the Southern Pacific and the Santa Fé.⁷³ The points which had been in dispute were settled substantially by the close of 1904, although there was considerable delay in completing the formal contracts covering the points at issue.

In the meantime, in September, 1904, Harriman informed E. P. Ripley, the president, and Victor Morawetz, the chairman of the executive committee of the Santa Fé, that he and some associates had made some large purchases of Santa Fé stock.⁷⁴ Among these associates were Henry Rogers, Henry Frick, Otto H. Kahn, and a number of other prominent financiers, and together they had acquired about \$30,000,000 of the Santa Fé's capital stock, or approximately 14 per cent of the entire issue.⁷⁵ In one interview which he had with Morawetz, Harriman declared that it was his belief that they ought to work to establish a better relationship between railroads, by dealing "more frankly with one another," and by operating their lines "not for the purpose of destroying one another but to help one another." With this end in view Harriman asked that his interests and those of his associates be accorded representation on the Santa Fé board.

Morawetz appears to have been unwilling to accord representation to the Harriman interests on the board of directors of the Santa Fé, so long as the differences between the Santa Fé and the Southern Pacific remained unadjusted. Since, however, under a cumulative system of voting which was provided in the Santa Fé's charter it would have been possible for the Harriman interests to obtain eventually four representatives on the Santa Fé's board, the Santa Fé officials after an agreement had been reached in regard to the lines in Arizona and in

⁷³ Proc. Spec. Ex., pp. 530 ff., complainant's exhibits 75-78. The 40-mile gap in a through rail line from San Francisco to Eureka has only recently, since the beginning of the year 1915, been completed.

⁷⁴ Testimony of E. P. Ripley before I. C. C. in 1907; also Proc. Spec. Ex., p. 1137, testimony of Morawetz.

⁷⁵ Evidence before I. C. C., Proc. Spec. Ex., p. 757, testimony of E. H. Harriman; and Proc. Spec. Ex., p. 1136, testimony of Victor Morawetz.

northern California no longer opposed Harriman's request. In February, 1905, Frick and Rogers who were at the time both members of the board of directors of the Union Pacific, were elected to the Santa Fé board.⁷⁶

In 1906, Harriman and the men associated with him in the Santa Fé purchase sold out their personal interests, being the above-mentioned \$30,000,000 of stock.⁷⁷ In the same year, the Union Pacific acquired the interest of \$10,000,000 in Santa Fé stock which has already been mentioned.⁷⁸ Whether the stock so acquired by the Union Pacific was part of the \$30,000,000 originally owned by Harriman and his associates, Harriman declined to state;⁷⁹ but according to Otto H. Kahn the shares purchased by the Union Pacific were not included in the original \$30,000,000 stock purchase; the \$10,000,000 purchased by the Union Pacific, said Kahn, were preferred, the \$30,000,000 acquired by Harriman and associates were common shares.⁸⁰ The two Union Pacific directors who were on the Santa Fé board, Frick and Rogers, had been elected ostensibly to represent the personal holdings of Harriman and his friends; nevertheless, after the personal interest of Harriman and his associates in the Santa Fé was reduced to the extent of the Union Pacific's holdings of Santa Fé stock, these two men continued to act as members of the Santa Fé board.⁸¹ This situation continued unchanged until the Union Pacific sold its Santa Fé holdings, in 1909.

Extent of Harriman Influence

These events indicate the way in which the control of railroads was tending toward centralization. By 1907 Harriman controlled the Union Pacific, and through it the miscellaneous railroad and steamship lines owned by the Southern Pacific

⁷⁶ Proc. Spec. Ex., p. 968, complainant's exhibit 99.

⁷⁷ *Ibid.*, pp. 4761, 4762, testimony of Kahn.

⁷⁸ See p. 311.

⁷⁹ Evidence before I. C. C., Proc. Spec. Ex., p. 757, testimony of E. H. Harriman.

⁸⁰ Proc. Spec. Ex., p. 4762, testimony of Kahn.

⁸¹ *Ibid.*

Company; he controlled indirectly a half-interest in the San Pedro, Los Angeles and Salt Lake Railroad, and a half-interest in the Northwestern Pacific Railroad; through the Union Pacific he dominated the management of the Illinois Central and the St. Joseph and Grand Island, and controlled "community of interest" holdings in other companies, including such large railroad systems as the New York Central, the Alton, and the Baltimore and Ohio. The only rail competitor of the Union Pacific-Southern Pacific system, the Santa Fé, was operated in complete harmony with the Union Pacific and Southern Pacific roads, and the Union Pacific enjoyed a "community of interest" representation in the Santa Fé management. The Southern Pacific Company, in addition to its own steamship lines, controlled the Pacific Mail Steamship Company; the Union Pacific, through the Oregon Railroad and Navigation Company, owned and still owns both the Portland and Asiatic Steamship Company, and the San Francisco and Portland Steamship Company. The Southern Pacific owned and still owns the Los Angeles street railway and inter-urban system, and the street railway system of Ogden, while the Union Pacific and Southern Pacific companies also possessed large interests in coal, oil, land, town-site, and other companies.

The Interstate Commerce Commission in 1907, referring to the extension of the Harriman-Union Pacific stock interests, said:

These are conspicuous illustrations of the development of the theory of "community of interest" and "harmony of management" which Harriman suggested when he demanded representation upon the Santa Fé board. . . . If the policy of purchasing and controlling stocks in competing lines is permitted to continue, it must mean suppression of competition.⁸²

It is not necessary to favor a return to the conditions of cut-throat competition, which prevailed between rival lines

⁸² 12 I. C. C. Rep. 346.

before the close of the last century, to recognize the truth of the above statement of the Interstate Commerce Commission. Whatever may be the economic advantages or disadvantages of competition among railroads, the necessary result of the Harriman policy was to restrict, if not to eliminate, whatever competition already existed. The Interstate Commerce Commission said:

To gather under one head all existing transcontinental lines, or as many as possible, and to exclude the incoming of all competitors became manifestly the Harriman policy, which was inaugurated in 1901 by the issuance of \$100,000,000 of convertible bonds by the Union Pacific.⁸³

This statement is supported by Harriman's frank admission that it was only the law that prevented the concentration of every transcontinental line in his hands. He declared that he was in favor of still more consolidation.⁸⁴ While Harriman was on the witness stand during an investigation of the Harriman roads which the Interstate Commerce Commission made in 1907, one of the commissioners, Mr. Lane, called Harriman's attention to the growth and concentration of his vast transportation interests and how they began with the Union Pacific, and then extended to Portland and by water from there to the Orient; to San Francisco and from there to the Orient; from San Francisco to New Orleans, and from New Orleans to New York by water; how he held a certain control over the Illinois Central and the Alton; and possessed, through the Union Pacific, large holdings in the Baltimore and Ohio, and in the New York Central; then Commissioner Lane asked of him, "Where is that thing going to stop?" "I would go on with it," answered Harriman, "if I thought we could realize something more than we have got from these investments, I would go on and buy some more things." Commis-

⁸³ 12 I. C. C. Rep. 322.

⁸⁴ Evidence before I. C. C., Proc. Spec. Ex., pp. 764, 765, testimony of E. H. Harriman.

sioner Lane then mentioned the Santa Fé. "If you will let us," said Harriman, "I will go and take the Santa Fé tomorrow." The following is an extract from Harriman's testimony:⁸⁵

Q. You would take it tomorrow?

A. Why certainly I would; I would not have any hesitation; it is a pretty good property.

Q. Then it is only the restriction of the law that keeps you from taking it?

A. I would go on as long as I lived.

Q. Then after you had gotten through with the Santa Fé and had taken it, you would also take the Northern Pacific and Great Northern if you could get them?

A. If you would let me.

Q. And your power, which you have, would gradually increase, as you took one road after another, so that you might spread not only over the Pacific coast, but spread out over the Atlantic coast?

A. Yes, but hasn't your organization increased its power?

Q. It undoubtedly has. That is what I am coming to. Do you think the law itself should intervene there and restrict you in your power to use money raised for railroad purposes and raised on railroad securities to the actual improvement of that railroad, or should you be allowed to use it for the acquisition of other railroads?

A. I think we should be allowed to use it for the acquisition of other railroads, under proper regulation.

A map of western rail and water lines shows that so far as California and the states of the southwest are concerned, the Harriman system constituted a partial monopoly of western transportation. That this was the case was indirectly admitted by Traffic Director Stubbs, in his testimony before the Interstate Commerce Commission. Speaking of the California situation, Stubbs declared: "They (the California merchants) are more or less dependent upon the Southern Pacific as they are not upon any other carrier, not even the Santa Fé."⁸⁶ That

⁸⁵ Evidence before I. C. C., Proc. Spec. Ex., pp. 802, 803.

⁸⁶ Proc. Spec. Ex., p. 3911, testimony of J. C. Stubbs.

the Southern Pacific had almost a monopoly of the business of California was openly declared by Judge Robert S. Lovett, the general counsel of the Harriman lines, in an argument before the Interstate Commerce Commission;⁸⁷ in fact, Lovett defended the Union Pacific-Southern Pacific combination by pointing out that the geographical position of the Southern Pacific was such that it already controlled three of the four all-rail approaches to California, so that the competitive situation was not affected by the Union Pacific-Southern Pacific combination.

Effect of Merger on Movement of Traffic

It is necessary to consider somewhat how this combination affected competitive conditions, and what was the result in regard to the transportation facilities furnished to the shipper and the traveler. For transcontinental traffic between the Atlantic seaboard and California, there had been, prior to 1901, a spirited competition between five routes: the American-Hawaiian line of steamers via the Straits of Magellan, and after the construction of the Tehauntepec Railway in 1904, via the Isthmus of Tehauntepec; the Panama route, via the Pacific Mail line to San Francisco; the Southern Pacific Sunset water and rail route via New Orleans; the all-rail route via the Santa Fé; and the all-rail route via Ogden. The last named route offers a choice of the Denver and Rio Grande and the Union Pacific as far as Ogden, but, owing to the poorer facilities, the inferior physical maintenance, and longer distance of the Rio Grande, the bulk of the traffic via the Ogden gateway has generally gone over the Union Pacific. Of these five routes, the Southern Pacific controlled one, the Sunset, for the entire distance, and part of one of the other four, namely, that portion of the Ogden route between Ogden and San Francisco. After the Southern Pacific had acquired the Pacific Mail, in 1900, it also controlled that portion of the Panama route which

⁸⁷ Argument of R. S. Lovett before I. C. C. in 1907, pp. 78 ff.

is between Panama and San Francisco. In the Santa Fé Company the Harriman system acquired in 1905 an important "community of interest" representation, which to a considerable extent limited the competition of this road. The American-Hawaiian line remained as an independent factor, and the only entirely independent factor, in transcontinental traffic.

Traffic between interior points of the Mississippi Valley and California had the choice of the three routes via the Ogden gateway, via the Santa Fé, or via the Southern Pacific by way of New Orleans or El Paso. The testimony of soliciting agents and of shippers is to the effect that prior to 1901, the Union Pacific and the Southern Pacific competed vigorously for traffic between eastern and middle western points and California. Southern Pacific agents sought to route traffic via the Sunset route, which gave the Southern Pacific the long haul; but these agents preferred the Ogden route, which gave the Southern Pacific the haul of 850 miles from Ogden to San Francisco, to losing the shipment altogether. After the two systems, the Union Pacific and the Southern Pacific, were amalgamated, the competition between them for transcontinental traffic ceased, but competition between the lines leading up to the Union Pacific at Omaha or at Denver, continued as before.

After the combination, instructions were issued to the representatives of both companies that the Union Pacific and the Southern Pacific were to be considered as one system, and that traffic was to be thereafter worked with a view to producing the greatest revenue for the system as a whole. The agencies of the two systems were consolidated everywhere except in New York City. Agents were instructed to influence certain business by way of the New Orleans or the El Paso gateway,⁸⁸ and certain other business by way of Omaha, in

⁸⁸ Transcontinental traffic moving by way of New Orleans is said to move by way of the "New Orleans gateway," traffic moving by way of the Texas and Pacific or by way of the Rock Island, to El Paso, Texas, and thence westward by way of the Southern Pacific moves via "the El Paso gateway."

accordance with certain prepared statements showing the routes by which the allied lines would receive the greatest return.⁸⁹ Traffic originating in the region commonly known as "New York and Boston and common points territory," that is, traffic of the Atlantic seaboard north of Norfolk, Virginia, and east of Pittsburgh and Buffalo, was influenced via the Sunset-Gulf route. West of Pittsburgh, traffic north of a line roughly corresponding with the Ohio River was influenced via the Ogden route, while traffic to the south of the Ohio was solicited via the Sunset. The same practice was followed with reference to Mississippi Valley business. Traffic originating in or destined for northern points in the Mississippi Valley was solicited via the Union Pacific, while traffic originating in or destined for points farther south went via the Sunset.⁹⁰ In other words, traffic was influenced to follow the lines of least resistance, the competition of the Union Pacific and Southern Pacific being completely eliminated as a factor in the situation.

One effect of the combination was that more through business went via Omaha than had previously been the case.⁹¹ The business of northern Ohio, which had formerly been solicited via both routes, was no longer solicited via the Sunset.⁹² The same thing appears to have been true of Illinois and Indiana, particularly after the Union Pacific had acquired its dominating influence in the Illinois Central. After 1906, agents of the Illinois Central ceased soliciting transcontinental business via their line in connection with the Southern Pacific.⁹³ Out of a number of instances which might be cited to show the effect of the Union Pacific-Southern Pacific combination on the movement of traffic, one commodity may be selected as an illustration of the changed conditions. Shipments of hops grown in the Willamette Valley in Oregon which were destined

⁸⁹ Proc. Spec. Ex., p. 2951, testimony of H. G. Toll.

⁹⁰ *Ibid.*, p. 2715, testimony of Thaddeus Sweek; p. 2243, testimony of M. C. Markham.

⁹¹ *Ibid.*, p. 1646, testimony of George Krause.

⁹² *Ibid.*, p. 1634, testimony of John Hart.

⁹³ *Ibid.*, p. 1836, testimony of H. H. Gin.

1836, testimony of F. M. Tol.

for Cincinnati had formerly been solicited by way of the Sunset route, as against the Oregon Railroad and Navigation Company-Union Pacific lines.⁹⁴ Since the merger, this hop traffic, which was considerable, went over the Union Pacific. Thomas McCusker, the assistant general agent of the Harriman lines, testified in 1909:

Hops go Union Pacific now. We forced as much hops as we could for Cincinnati by the Sunset Route, but since the merger the instructions are the other way.

Q. Cincinnati is quite a brewery town, isn't it?

A. Yes.

Q. It is a hop market?

A. Pretty fair hop market, yes sir.

Q. And there used to be pretty active competition between the O. R. & N. and the Southern Pacific for that traffic?

A. Yes, sir.⁹⁵

The effect of the merger was by no means confined to California or Oregon transcontinental traffic. The Oregon Short Line and the Southern Pacific route via Sacramento had previously been competitors for traffic between Ogden and points east and south of Ogden, and Portland and points in the Willamette Valley. The Southern Pacific also carried out of Portland, via the Sunset, some transcontinental tonnage destined for northern Mississippi Valley points, but it seems this route was not a favorite one for this traffic.⁹⁶ The Union Pacific, through its subsidiary, the Oregon Railroad and Navigation Company, moreover operated in the Willamette River a line of steamships which served as a feeder to its main through line, and which competed, though to a limited degree, with the Southern Pacific local rail lines for local Willamette Valley traffic. The extent of this boat competition depended upon the stage of the water; but when navigation permitted, steamers reached Corvallis, Oregon, and it seems that in high

⁹⁴ Proc. Spec. Ex., p. 2731, testimony of Thomas McCusker.

⁹⁵ *Ibid.*, p. 2740, testimony of McCusker.

⁹⁶ *Ibid.*, p. 2802, testimony of Samuel H. Moore; p. 1298, testimony of Andrew Paar.

water, steamers sometimes went as far up the river as Harrisburg, Oregon, 100 miles south of Portland.⁹⁷ After the merger this competition ceased.

Traffic originating in the region about Portland, consisting principally of hops, wool, and lumber, had been competitive between the Union Pacific and Southern Pacific systems, and while this traffic was relatively small compared with the total volume of traffic of either system, it was nevertheless considerable, and both the Southern Pacific and the Union Pacific through the Oregon Railroad and Navigation Company had prior to 1901 been very active in soliciting it for their respective lines.⁹⁸ At one time during the period of the Union Pacific receivership, when the Oregon Short Line was not operated as a part of the Union Pacific system, some differences arose between the Union Pacific and the Oregon Short Line, and, as a competitive measure, the Union Pacific and Southern Pacific, in 1897, had operated for a short time a fast through freight service from the east to Portland by way of Sacramento.⁹⁹ The Oregon Short Line was on the whole a more satisfactory route from Portland to Ogden and points east of Ogden, but the Southern Pacific line had, prior to 1901, been a factor in this business.¹⁰⁰ After the merger, through rates via Sacramento between Portland common points and Ogden and points east and south of Ogden, were withdrawn, and all of the traffic of the Willamette Valley region was now carried over the Oregon Short Line, to the exclusion of the route via Sacramento.¹⁰¹ The same thing was done in regard to traffic originating in local Southern Pacific points farther south than the Willamette Valley. This traffic had formerly moved only over the Southern Pacific. Shipments from points as far south as Medford, Oregon, 329 miles south of Portland, were

⁹⁷ *Ibid.*, p. 2682, testimony of H. M. Adams; p. 2693, testimony of Robert Graham.

⁹⁸ Evidence before I. C. C., Proc. Spec. Ex., p. 414, testimony of McCusker.

⁹⁹ Proc. Spec. Ex., p. 2731, testimony of McCusker.

¹⁰⁰ *Ibid.*, p. 2388, testimony of Stephen H. Babcock.

¹⁰¹ Evidence before I. C. C., Proc. Spec. Ex., p. 412, testimony of McCusker.

after 1901 carried north to Portland and thence east over the Oregon Short Line.¹⁰²

Between Portland and San Francisco, the Oregon Railroad and Navigation Company operated a line of steamers in competition with the Southern Pacific Shasta route. At one time in the late nineties there had been a war of rates between these two routes,¹⁰³ but, except during this war, the boat line enjoyed a differential as against the all-rail line on business between those two points. The two routes were competitive, although in the matter of rates the railroad did not attempt, except during this rate war, to meet competition of the boat line.¹⁰⁴ After the merger this competition also ceased.

According to a report of the Interstate Commerce Commission made in 1907, the route via the Union Pacific system to Portland, and thence by boat to San Francisco, might have been made a factor in the competition for transcontinental business. The bulk of evidence, however, upon which the Interstate Commerce Commission's report is based, and later and more detailed evidence taken in 1909 and 1910 fails to support this opinion of the Interstate Commerce Commission. There is little reason to doubt that had the Union Pacific attempted to influence through traffic over that route, the Southern Pacific could have retaliated so as to have seriously injured the Union Pacific, by diverting the overland traffic of California from the Union Pacific to the Denver and Rio Grande. The evidence of shippers and railroad men alike is to the effect that very little traffic had ever gone this way, and that it was an impracticable route, as against the through all-rail line and a negligible factor in transcontinental competition. The purchase of the Southern Pacific by the system owning this Portland route therefore cannot be considered as in any sense restraining the competition of this broken rail-and-water line,

¹⁰² Proc. Spec. Ex., p. 2766, testimony of J. D. Olwell.

¹⁰³ *Ibid.*, pp. 3353 ff., copies of tariffs.

¹⁰⁴ *Ibid.*, p. 2029, testimony of J. C. Stubbs.

as there was no likelihood that there would ever be any such competition.

The Union Pacific and Southern Pacific lines had competed formerly for business moving between California and Montana points. The Sunset-Gulf lines and the Union Pacific all-rail route had also offered alternative routes between the east and Colorado points; but the combination can hardly be said to have seriously "restrained trade," so far as business east of Denver is concerned, since even though all competition between the Union Pacific and Southern Pacific were eliminated, there are a number of other independent lines which connect Colorado with the east.

Unrestrained Railroad Competition Not Desirable

Enough has been said in a general way to indicate the limits within which the Union Pacific and Southern Pacific may be classed as competing lines, and to show to how great an extent the combination really came within the inhibition of the Sherman Anti-Trust Law. The Union Pacific and Southern Pacific, however, claimed that the only traffic in respect to which the two systems were competitive was eastbound business originating at Portland. Said Milburn, an attorney for the Harriman roads:

I submit that railroads are only competitive as to any traffic when they can take it at the point where it originates and put it on their road. . . . If this be the true view, the Union Pacific and Southern Pacific are not competitors excepting with respect to transcontinental east-bound traffic originating at Portland, and as Judge Lovett has shown, that is an infinitesimally small quantity.¹⁰⁵

The above definition was narrow and failed to take into account the fact that the Union Pacific and Southern Pacific had prior to 1901 been competitors for transcontinental traffic, between Ogden and Portland, between Portland and San

¹⁰⁵ Argument of Milburn before the I. C. C., p. 119.

Francisco, and other traffic for which the two systems had competed. Such arguments are misleading. Even though the volume of traffic which might reasonably be classed as competitive between these two systems, including not only the outgoing business of Portland and the Willamette Valley—which the representatives of the two systems claimed was the only competitive traffic between them before the merger—but also transcontinental business, and all other traffic for which both systems had previously competed, was relatively small compared to the total earnings of the two companies, it was nevertheless large in the aggregate.

The transcontinental competition between the two roads was probably not so effective as it would have been had the Union Pacific owned a rail line of its own to San Francisco, but the Union Pacific was a powerful factor in the competitive situation. The purchase of the Southern Pacific by the Union Pacific eliminated that competition. The volume of competitive traffic prior to the combination had been sufficient to stimulate the activity of each road to secure it.

A railroad is necessarily to a very large extent a monopolistic institution; for even though it may be one of two or more railroads operating between the same terminals, it is exposed to competition only so far as the through traffic is concerned. The amount of traffic for which the Union Pacific and Southern Pacific had competed was, it is true, relatively small, yet these two lines were according to the interpretation which is commonly given to the word "competition," as applied to railroads, "competing lines." The declared economic policy of the United States has been to foster competition among railroads as well as among industrials; and legislation, both national and state, has attempted to enforce this principle in the hope that through its operation reasonable rates and attractive service would be secured.

At one time, before the day of rate commissions and interstate commerce laws, the public relied upon competition

alone to secure reasonable railroad rates. During the earlier period of American railroad history there was real competition in through rates, which resulted in frequent wars of rates between rival lines. This cut-throat competition failed completely as a force upon which the people could depend to secure satisfactory rates. The situation only resulted in great fluctuations in rates to the detriment of both the railroads themselves and of the communities they served. Abnormally low rates between competitive points were not and could not be accompanied by a proportionate lowering of local rates, which were maintained at as high a level as possible in order to compensate the roads for their losses in reductions which were made in through rates. As a result, local non-competitive communities were loud in their protests against long and short haul discriminations. The situation was still further aggravated by secret rate-cutting, and competition became a cause, or at least furnished an excuse, for the iniquitous practice of rebate-giving.

Abnormally low competitive rates which prevailed during rate wars were not permanent, and it was usually not economically desirable that they should be permanent. The rate war resulted in disaster to the weaker line, and often in its absorption by the stronger, or in a pooling arrangement. Pooling contracts were not enforcible by law, and the testimony of men connected with railways during the eighties is that pools were frequently disregarded by the officers of rival companies. The Interstate Commerce Act of 1887 declared pools to be illegal, the obvious intention of the law being to enforce rate competition between railroad companies.

One other result of the unrestrained competition of the earlier period should be mentioned: This was the unnecessary paralleling of roads where traffic did not warrant it. The decade of the eighties especially was a period of speculative railroad building, when lines were projected and constructed without regard to the country's real transportation needs, or

to the crop of receiverships which were likely to follow over railroad building.

Pools; Rate Agreements; Interstate Commerce Act

"Railroad pools are contracts between rival railway companies whereby, in order to prevent competition, their business is united in one common total from which the business or the money received therefor is divided among the combining companies in fixed percentages."¹⁰⁶ Pools may be of two kinds, traffic pools and money pools.

[The former] is an agreement allotting a certain percentage of the total traffic to each road, and providing that if any road exceeds its share of the business, freight shall be diverted from it to other roads until the agreed proportion is restored. A money pool is an agreement whereby the money received by all the combining roads for transportation is brought together into one total and divided among the roads in certain fixed percentages, which do not necessarily correspond to the proportion of freight actually carried by each road.

The pool was therefore materially different from, and also more open to objection than, the simple agreement to maintain rates. An agreement to maintain rates did not really restrict competition for business, only, instead of taking the form of rate-cutting, competition is then in the matter of service. But, the pool, limiting as it does the proportion of each road, removes all incentive to competition in any form.¹⁰⁷ Efforts were made by the railroads during the nineties to secure the passage of a federal act legalizing pooling, but these efforts were not successful. Later, in the *Trans-Missouri*¹⁰⁸ and *Joint Traffic Association*¹⁰⁹ cases, the United States Supreme Court held that even agreements to maintain rates were contracts in restraint of trade, and in violation of the Sherman

¹⁰⁶ 23 Am. & Eng. Ency. of Law, 2nd Ed., 664.

¹⁰⁷ This would appear to be the principal weakness in the present railroad law which, because of its so-called "contingent fund" provisions, is not unlike a general pool.

¹⁰⁸ *United States v. Trans-Missouri Freight Association*, 166 U. S. 290, 19 S. Ct. 540, 41 L. Ed. 1007.

¹⁰⁹ *United States v. Joint Traffic Association*, 171 U. S. 505; 19 S. Ct. 25; 43 L. Ed. 259.

Law. The consequence was that the problem of railroad rates remained unsolved, the country for some reason continuing to place an unwarranted dependence upon competition to bring about the desired result—fair uniform rates.

A step in advance was made in 1889, when the Interstate Commerce Law was amended so as to prohibit railway companies from making reductions in the published tariffs, except after three days' notice.¹¹⁰ The notice required was later, in 1906, increased to thirty days.¹¹¹ Its effect was virtually to establish under legal compulsion a general agreement among railroads to maintain rates, and to put a stop to all real rate competition. It may now be taken as reasonably certain that there is now little or no secret cutting of rates. Rate wars are now considered things of the past. Said Traffic Director Stubbs in 1907:

The Interstate Commerce Law will be very effective in restraining practices that, while in the past were lawful or at least not prohibited, have been detrimental to the interests of the public and the carrier. I have particularly in mind in saying this, the midnight tariff that is killed by the thirty days' notice clause, and also the fact that the thirty days' notice clause is going to make a stability of rates generally that has not obtained.¹¹²

Rate Changes on the Union Pacific and Southern Pacific

Nevertheless under the restrictions which were, by the law of 1906, placed upon destructive rate competition, the existence of competing lines might and doubtless did have some influence in keeping rates down. This was admitted in 1907 by R. B. Miller, the general freight agent of the Southern Pacific lines in Oregon, and the traffic manager of the Oregon Railroad and Navigation Company. In explaining to the Interstate Commerce Commission the reason why the rates from San Francisco to certain non-competitive points in eastern

¹¹⁰ 25 Stat. L. 855.

¹¹¹ 34 Stat. L. 586.

¹¹² Evidence before I. C. C., Proc. Spec. Ex., p. 335, testimony of J. C. Stubbs.

Washington and Idaho had been raised, after the merger, while rates to other local points in the same territory where the Harriman lines met the competition of the Northern Pacific remained as they had been before, Miller admitted that competition had been the cause which had prevented an advance in rates to the competitive points; he declared, however, that it was not the competition of the Northern Pacific, but the competition of steam schooners plying between San Francisco and Puget Sound ports that prevented an increase in rates to these local competitive points.¹¹³

In 1909, western freight tariffs were generally higher than they had been in 1900. To be sure an advance in transcontinental tariffs did not follow immediately upon the combination of the Union Pacific and Southern Pacific, and in fact, without the agreement of other transcontinental lines, especially the Santa Fé, a rate advance could not be made by the Harriman roads. Overland rates were raised about 1905. It cannot, however, be said with certainty that the extension of the Harriman influence through combination or "community of interest" was responsible for this increase. The following illustrations may be mentioned to show how the western railroad rates were advanced after, though not necessarily in consequence of, the merger. For example: Prior to the combination of the Union Pacific and Southern Pacific, the Oregon Short Line and Southern Pacific, had, it seems, competed actively for wool shipments in the region west and north of Great Salt Lake, where sheep can be driven to way stations on either line.¹¹⁴ Shipments secured by the Southern Pacific might be sent east directly, or might be carried west to California, and thence east via the Sunset route. After the consolidation, this competition ceased; and in April, 1903, rates on wool shipped to New York from stations on the Oregon Short Line between Huntington, Oregon, and Kuna, Idaho, ad-

¹¹³ Proc. Spec. Ex., p. 4504, testimony of R. B. Miller.

¹¹⁴ *Ibid.*, p. 2527, testimony of Joseph Ogelsby; p. 2538, testimony of Joseph W. Summerhays; p. 2659, testimony of W. C. McBride.

vanced from \$2 to \$2.17½ per hundred pounds, while rates on wool shipped to New York from Southern Pacific points between Kelton, Utah, and Wadsworth, Nevada, advanced from \$2 to \$2.18½ per hundred pounds.¹¹⁵ A statement tabulated by the Interstate Commerce Commission shows that on 6 out of 7 selected commodities, the west-bound trans-continental rate from New York increased sharply early in 1904,¹¹⁶ and that of eighteen selected commodities the trans-continental rate on 13 advanced sharply on January 1, 1909.¹¹⁷ The same thing was true of overland rates to the Pacific Coast from points farther inland than "New York and common points territory." However, class rates¹¹⁸ appear not to have greatly varied during this period, and any advances that were made in certain classes were offset by reductions on other classes.¹¹⁹

Between Portland and San Francisco, both water and rail rates advanced after 1904, although the same differential in favor of the water lines continued. Class rates on the rail line advanced as follows:¹²⁰

PORTLAND TO SAN FRANCISCO										
Effective	I	2	3	4	5	A	B	C	D	E
Feb. 20, 1900...	51	41	31	26	18	23	23	18	18	18
Jan. 10, 1904...	51	41	36	31	25	25	25	25	25	25
July 15, 1905...	51	41	41	41	28	28	28	28	28	28

Other instances might be selected to illustrate the rate advances which have occurred in the region served by the Union Pacific-Southern Pacific lines. Rate increases were general. "Everything tightened down, after this so-called merger took place," testified one wool shipper of Salt Lake City.¹²¹ During the recent government suit against the Harri-man lines, C. A. Severance, the attorney for the government,

¹¹⁵ *Ibid.*, p. 3361, copies of tariffs, complainant's exhibit 189.

¹¹⁶ *Ibid.*, p. 866, complainant's exhibit 81 A.

¹¹⁷ *Ibid.*, p. 878, complainant's exhibit 81 H.

¹¹⁸ The distinction between class rates and commodity rates must be borne in mind.

¹¹⁹ Proc. Spec. Ex., pp. 877-9, complainant's exhibits 81 G, 81 I.

¹²⁰ *Ibid.*, p. 3353, complainant's exhibit 183 A.

¹²¹ *Ibid.*, p. 2545, testimony of Summerhays.

asked a large shipper of Chicago, "How are your transcontinental rates now compared with what they used to be?" The shipper replied, "More excessive, Mr. Severance; in fact they are prohibitory. Our business has dwindled down to practically mighty little car shipments."¹²²

It would be a one-sided and not fully supported statement to say that for these rate advances, which are evidenced by the published tariffs and by the testimony of shippers, the merger was directly responsible. There is no doubt that a part of the increase may fairly be ascribed to the general upward trend of prices since 1900. On account of the fact that control of railroad rates has by later legislation been given to the Interstate Commerce Commission, it is not likely that competition or the lack of competition will have any further bearing upon rates.

Character of Service After the Merger

Competition in service involves such elements as speed, equipment, the personality of soliciting agents, and the satisfactory and prompt adjustment of claims for damages and overcharges. In the matter of equipment, the Harriman roads were as well able to satisfy the shipper and the traveler as any railroad line in the country. Says the Interstate Commerce Commission:

It has been, however, no part of the Harriman policy to permit the properties which were brought under the Union Pacific control to degenerate and decline; as railroads they are better properties today, with lower grades, straighter tracks, and more ample equipment than they were when they came under that control.¹²³

There is no evidence that the physical condition of the allied lines deteriorated in any respect after the merger; in fact the reverse is true. The service was generally improved after the merger, except that the scheduled time of trains, both freight

¹²² *Ibid.*, p. 1953, testimony of Peter B. Heinrichs.

¹²³ 12 I. C. C. Rep., 323.

and passenger, was considerably longer after the merger than it was in 1900. This was true on both the Sunset and Ogden routes; but whether or not this was due to lack of serious competition must remain a matter of surmise. It is explained reasonably satisfactorily by the operating officials of the system as due to the congestion of traffic and to the frequent "slow orders" which were rendered necessary by the construction work along the lines.¹²⁴ Nor does it appear that this circumstance occasioned any very serious complaint.

To the statement that the service of the Harriman properties improved after the merger there are two conspicuous exceptions. The boat service between Portland and San Francisco deteriorated from a four-day to a five-day, and later to a weekly service.¹²⁵ Portland shippers complained of the inferiority of this service; and it appears that in consequence of poor steamer accommodations, shippers who had been in the habit of using the cheaper water route were now forced to use the rail line of the Southern Pacific.¹²⁶ It should be mentioned in this connection, that the local Willamette Valley steamship service of the Oregon Railroad and Navigation Company also deteriorated. Service between San Francisco and Panama via the Pacific Mail became extremely unsatisfactory. The boats on this line were out of date, they did not have sufficient space and they were characterized by shippers as a "lot of tubs."¹²⁷ The object of this policy with respect to the Panama service was obviously to lessen the use of this route as a transcontinental line between the east and California, and to stimulate traffic by way of the rail routes.

During an Interstate Commerce Commission investigation in 1907, one of the commissioners suggested to a witness, Mr. Hannaford of the Northern Pacific, who had been making a

¹²⁴ Proc. Spec. Ex., p. 4322, testimony of William L. Park; also testimony of Kruttschnitt and Lomax.

¹²⁵ *Ibid.*, p. 2638, testimony of D. C. O'Reilly; evidence before I. C. C., Proc. Spec. Ex., p. 3403, testimony of R. P. Schwerin.

¹²⁶ Testimony of Newbegin and Lynn, Portland shippers, before I. C. C. in 1907.

¹²⁷ Proc. Spec. Ex., p. 2997, testimony of A. L. Scott; *Ibid.*, p. 3098, testimony of C. L. Michaels; see also testimony of other California shippers.

sweeping defense of the monopoly as an institution, that the excellent railroad passenger service between Chicago and St. Paul was due to the fact that there were a half-dozen lines competing for the business, while the "midnight horrors" between New York and Boston were a result of the New Haven's monopoly of the New England transportation business.¹²⁸ Undoubtedly, competition is a wholesome stimulant; but it must be well understood that the trains of the Union Pacific have at no time in the last twenty years been "midnight horrors." On the contrary, it is not likely that anyone who had had the opportunity of riding over the Union Pacific line during the last half of the decade from 1900 to 1910 could fail to observe the excellent character of the transcontinental service. The fact is that instead of deteriorating by reason of the lessening or partial elimination of competition, the service was materially improved.

While the traffic of the Pacific southwest was controlled largely by the Union Pacific-Southern Pacific system, competitive conditions in the transcontinental traffic of the Pacific northwest have always prevailed. There are at present five main routes from the Great Lakes to Oregon and Washington: the Union Pacific-Oregon Short Line, the Great Northern, the Northern Pacific, the Canadian Pacific, and, since 1909, the Chicago, Milwaukee and St. Paul. South of Portland, however, the Union Pacific-Southern Pacific system had a virtual monopoly, which, as explained above, was broken only by such competition as was offered by the American-Hawaiian line and by the Santa Fé; but the competition of the Santa Fé was, as explained, greatly lessened by the community of interest which the Union Pacific had in it. In this connection one important feature should be borne in mind: The Union Pacific-Southern Pacific system was the combining of compet-

¹²⁸ Evidence before I. C. C., p. 4824, testimony of Hannaford. That would appear to be the weakness of the Esch-Cummins Railroad Law, which limits the return a railroad can make and lessens many of the incentives to competition in service, without, however, securing the advantages of a general consolidation.

ing lines into a great unified non-competing system which exercised, directly or through community of interests arrangements, what was almost equivalent to monopolistic control of the traffic of the southwest and of California. However, during many years before this combination was effected, the Southern Pacific exercised a practical and equally effective monopoly over transportation in California. The control by the Southern Pacific of three of the four rail entrances to California, and one through water line from the east to California, namely, the Sunset, Ogden and Shasta all-rail routes and the water route by way of Panama, was equivalent to a monopoly, which, so far as California was concerned, was somewhat strengthened but not brought into existence by the Union Pacific-Southern Pacific combination; it is, moreover, clear that many of the objections raised to the Union Pacific-Southern Pacific combination were not warranted by the facts; and the evil consequences that were said to arise out of the combination were greatly exaggerated by popular prejudice.

CHAPTER XIII

THE DISSOLUTION OF THE UNION PACIFIC- SOUTHERN PACIFIC COMBINATION

Declaration of 10 Per Cent Dividend

As the decade from 1900 to 1910 advanced, the prosperity of the Union Pacific mounted higher and higher. In 1905 the *Commercial and Financial Chronicle* said in an editorial that the condition of its treasury was "plethoric."¹ Earnings increased rapidly each year. The gross receipts of the Union Pacific system² from transportation operations grew from \$51,075,188.96 for the fiscal year ending June 30, 1903, to \$67,281,542.60 for the year ending June 30, 1906, notwithstanding the fact that the total mileage of the system was 359 miles less in 1906 than it was in 1903. This decrease in mileage is accounted for by the sale of the Oregon Short Line's lines south of Salt Lake City to the San Pedro, Los Angeles and Salt Lake Railroad. During the same years, that is, from 1903 to 1906, the net earnings increased from \$22,327,972.87 to \$30,317,769.44. — In addition to its earnings from transportation, the Union Pacific realized millions of dollars annually from its security holdings in other roads. For the fiscal year ending June 30, 1903, the company's total receipts, including the income of securities owned, amounted to \$55,610,466.23. Each succeeding year brought a large increase, until for the year ending June 30, 1906, the company's total gross receipts amounted to \$77,661,358.20. At the close of the fiscal year 1903 the surplus over the fixed charges was \$15,276,642.47; in June, 1906, it amounted to \$31,764,673.66. During the fiscal year ending in 1903 the company's surplus for the year after the payment of dividends amounted to

¹ Chron., 81: 1639 (1905).

² Not including the lines of the Southern Pacific, or the San Pedro, Los Angeles and Salt Lake Railroad.

\$6,943,474.47; for the fiscal year ending June 30, 1906, the surplus for the year amounted to \$12,232,249.66.³

Until 1905 the dividend rate upon the common stock remained at 4 per cent per annum. In that year the rate was increased to 5 per cent. In the spring of 1906 the stock was placed on a 6 per cent basis. On August 15, 1906, the directors declared a semiannual dividend of 5 per cent upon the common stock, 3 per cent payable out of the company's earnings as a carrier, and 2 per cent out of its income which it derived as a holder of investment securities.⁴ On the same day the directors of the Southern Pacific Company declared a semiannual dividend of 2½ per cent upon that company's common stock. This was the first dividend which the Southern Pacific Company had paid upon its common shares. The action of its directors in declaring this Southern Pacific dividend gave an additional return to the Union Pacific of \$4,500,000 annually.

The dividend declaration of the Union Pacific made at this time was severely criticized in many quarters: That on the one hand, if the finances of the company justified the dividend, it indicated that the road was overcharging the public; that if the finances of the company did not justify it the dividend was a stock jobbing operation; and that the manner of declaring the dividend and the delay in its announcement was an act of bad faith on the part of the directors to the outside stockholders. It had been expected for some time that the Southern Pacific would soon pay a dividend upon its common stock; its earnings would have justified a dividend before this time, and individual stockholders of the Southern Pacific had at times expressed considerable dissatisfaction at the policy of the Harriman management in putting the company's earnings into physical improvements. With the Union Pacific the case was somewhat different. Notwithstanding the company's large earnings, to raise the dividend rate from 6 per cent per annum to 10 per

³ Annual Reports.

⁴ Evidence before I. C. C., Proc. Spec. Ex., p. 223, copy of minutes of directors' meeting.

cent per annum was a radical step, and in view of the prevailing attitude of the public toward railways, such a high rate of dividend was bound to attract unfavorable comment. The circumstance, moreover, received unfavorable comment for another reason. After the directors had voted to increase the dividend Harriman suggested at the same meeting that, as some of the directors were absent, the announcement of the dividend should be deferred until these absent directors could be informed of the action taken by the board, and that the announcement of the dividend should therefore be left to the executive committee. A resolution was thereupon passed, giving to the executive committee the power to declare the dividend and to take such action as might be deemed advisable. The executive committee met on the afternoon of the following day, August 16, and passed a resolution which directed the secretary of the Union Pacific to give notice of this increased dividend to the secretary of the Stock Exchange on August 17, before ten in the morning.⁵ The dividend was therefore declared on August 15, while its announcement was not made until August 17. Announcement of the Southern Pacific dividend was likewise deferred two days, that is from August 15 to August 17. The announcement of these dividends would necessarily affect the market value of both the Union Pacific and Southern Pacific stock. It was charged that Harriman and his associates had withheld the announcement of these dividends for speculative purposes. How much truth there may or may not have been in this charge cannot be learned from available sources of information.⁶

The large earnings of the Union Pacific did in fact justify the dividend of 10 per cent upon its common stock, and this dividend rate was maintained. The road's ability to pay with ease generous dividends upon a high capitalization, while at

⁵ Evidence before I. C. C., Proc. Spec. Ex., p. 224, copy of minutes of executive committee meeting.

⁶ Harriman refused to state whether he was directly or indirectly interested in any Union Pacific stock purchases made between July 19, 1906, and August 17, of the same year. (Evidence before I. C. C., Proc. Spec. Ex., p. 796, testimony of Harriman.)

the same time extending its control and influence over thousands of miles of railway, was partly a result of the economical policy of the management, partly a consequence of the phenomenal prosperity of the first few years of the twentieth century, and partly due to a fortunate speculation. The prevailing public opinion was, whether rightly or wrongly, that railways had, during the first fifteen years of the present century, been becoming too prosperous at the expense of the general public;⁷ and one of the most conspicuous examples of an apparently overprosperous road was the Union Pacific. A feature of the first decade of the twentieth century was the growth of great combinations of capital on the one hand, while during the same period a growing agitation developed for the dissolution of large combinations, or "trusts." "Trust-busting" and the restoration of competition were demanded by the public. The Harriman transportation system was not only placed by many persons in the class of "predatory railroad corporations," it was also looked upon in many quarters as a dangerous approach toward monopoly.

Interstate Commerce Commission Investigation

The widespread criticism of the Harriman "transportation monopoly" increased in the fall of 1906, after the declaration of the Union Pacific's 10 per cent dividend. It was partly due to this large Union Pacific dividend, and partly due to the charges of monopoly, that the attention of the Interstate Commerce Commission became more or less immediately fixed upon the Harriman system. On November 15, 1906, the Commission ordered an investigation into "the matter of consolidations and combinations of carriers, relations between such carriers, and community of interests therein, their rates, facilities and practices." The investigation was confined to the

⁷ It is unfortunate that popular prejudice as well as attempts at regulation seek rather as an end the lessening of railroad profits, since such course necessarily encourages extravagance and discourages investment in physical improvements. After it is determined what rates are reasonable the carriers should be allowed to retain the fruits of economy and efficiency. This is a serious weakness in the present Esch-Cummins Law.

Harriman roads, that is, to the Union Pacific and the roads in which the Union Pacific was interested. Testimony was taken by the Commission at New York, Chicago, Portland, Seattle, San Francisco, and Los Angeles.

The inquiry revealed the history of the Union Pacific system since the reorganization, as it has been outlined in the two preceding chapters. The evidence before the Commission showed that control of the system was centralized in Harriman's hands. The Union Pacific's vast purchases in the stocks of other roads had, it was shown, been made entirely at his instance; in these and other transactions he had acted on his own initiative, by virtue of his position as chairman of the executive committee of the Union Pacific, or of the Southern Pacific or of the Oregon Short Line; and the executive committees invariably ratified his actions. The "personal" management of the Union Pacific and its allied lines was found to be absolute.⁸

The Commission also pursued its inquiry into the history of the reorganization of the Chicago and Alton Company, but as the facts relating to this road do not directly bear on the Union Pacific, this feature of investigation need not be entered into in detail.

During this investigation of the Harriman lines, Harriman's testimony before the Commission attracted attention, not alone because of facts which were developed by his testimony, but also because of his refusal to answer certain questions regarding his stock transactions. He refused to reveal the extent of his interest in the Illinois Central stock which was sold to the Union Pacific; or whether this stock had been acquired by a syndicate or pool for the purpose of turning it over to the Union Pacific. He also refused to tell whether the Union Pacific had purchased its Santa Fé stock of him. Legal proceedings were later instituted by the Commission in order to compel Harriman to answer questions touching these mat-

⁸ 12 I. C. C. Rep. 320.

ters; but the United States Supreme Court sustained Harriman in his refusal to answer.⁹

As the facts which were brought out in the investigation have been elsewhere considered, it is not necessary to take them up here.¹⁰ The Commission in its report outlined the development of the Harriman lines from 1898 down to 1907. The report placed emphasis upon the growth of the Harriman-Union Pacific system, and the expansion of its influence, until in 1907 the system included the following railroads: the Union Pacific and its subsidiary lines, and the Southern Pacific; a half-interest in the San Pedro, Los Angeles and Salt Lake Railroad and in the Northwestern Pacific; a dominant interest in the Illinois Central and the St. Joseph and Grand Island; a large interest in the Baltimore and Ohio, and Chicago and Alton; a "community of interest" representation in the New York Central, and the Santa Fé; and smaller holdings in the Chicago, Milwaukee and St. Paul, and Chicago and Northwestern. There were also small amounts of Great Northern and Northern Pacific stock still owned by the Union Pacific. In addition, there were included within the combined system: the Southern Pacific Morgan line of steamships; the Pacific Mail Steamship Company; the Occidental and Oriental Steamship Company; the Portland and Asiatic Steamship Company; the San Francisco and Portland Steamship Company; and street railways in Ogden and Los Angeles.

Concerning the merger of the Union Pacific and the Southern Pacific, the Commission reported:

The effect of the control of the Southern Pacific by the Union Pacific has been to unify and amalgamate the management of these two railway companies and their steamship lines, and to eliminate competition between them in transcontinental business and in business to and from oriental ports.¹¹

The Commission made three general recommendations:¹²

⁹ *Harriman v. Interstate Commerce Commission*, 211 U. S. 407, 29 S. Ct. 115, 53 L. Ed. 253.

¹⁰ See *supra*, Chapters XI and XII.

¹¹ 12 I. C. C. Rep. 345.

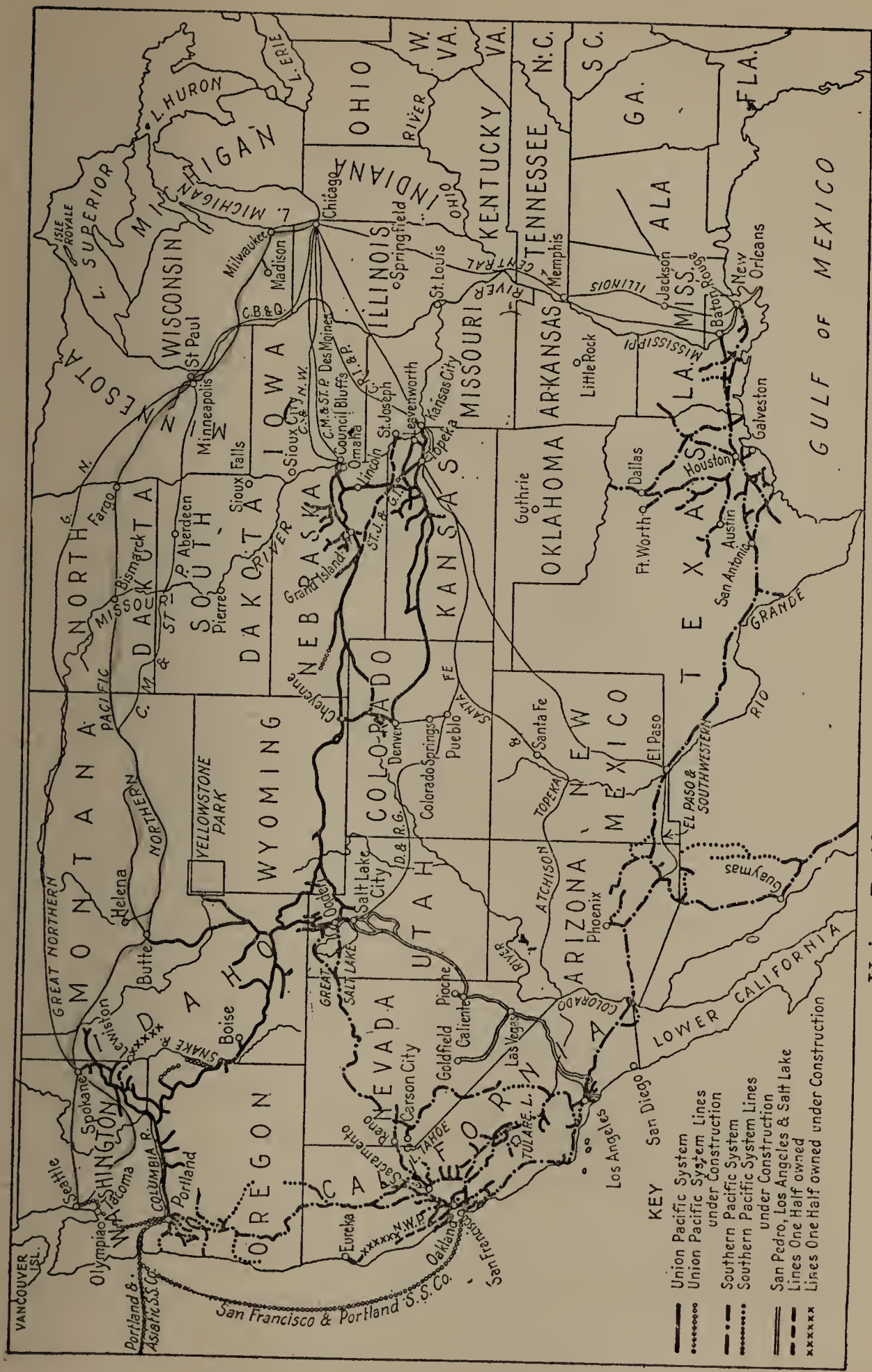
¹² 12 I. C. C. Rep. 346.

1. That the function of a railroad be confined to transportation, and that railroads be not permitted to invest in stocks and bonds of their roads, except of connecting lines, and that surplus funds be expended in developing the country and building feeder lines instead of in stock acquisition.
2. That it was contrary to public policy for one railroad to acquire control of parallel and competing lines. "Competition between railways," says the report, "as well as between other industries, is the established policy of the nation."
3. That some reasonable regulation be imposed upon the issuance of securities by railways, with a view of preventing their inflation for speculative purposes.

Government Suit to Dissolve Merger

The above investigation and report attracted wide publicity, and very soon bore fruit. On February 18, 1908, the local United States District Attorney for the district of Utah, acting under the direction of Attorney-General Charles J. Bonaparte, brought suit in the United States Circuit Court for the purpose of breaking up the Union Pacific-Southern Pacific combination, and of compelling the Union Pacific to dispose of its holdings in competing roads. The defendants were:

The Union Pacific Railroad Company	The Northern Pacific Railway Company
The Oregon Short Line Railroad Company	The Great Northern Railway Company
The Oregon Railroad and Navigation Company	The Farmers' Loan and Trust Company
The San Pedro, Los Angeles and Salt Lake Railroad Company	Edward H. Harriman
The Atchison, Topeka and Santa Fé Railroad Company	Jacob H. Schiff
The Southern Pacific Company	Otto H. Kahn
	James Stillman
	Henry H. Rogers
	Henry C. Frick
	William H. Clark



Union Pacific and Southern Pacific Systems, 1908

As a consequence of the Northern Securities case, and of the manner in which the Northern Securities Company was dissolved, the Union Pacific system had acquired large stockholdings in the Great Northern and Northern Pacific. The greater part of these holdings had been disposed of by 1908; but the Union Pacific, through the Oregon Short Line, still held small amounts of stock in both the Great Northern and Northern Pacific.

The complaint recited briefly the events which eventually resulted in the situation as it was in 1908, and alleged in substance: that the defendants Harriman, Schiff, Kahn, Stillman, and the Union Pacific Railroad had acquired a controlling interest in the Southern Pacific Company with a view "to place restraint upon all competitive interstate and foreign trade and commerce carried by them, and to monopolize and attempt to monopolize the same, and to suppress the competition theretofore existing between the same in interstate and foreign trade and commerce"; that "the same defendants, and other parties to complainant unknown" caused the Union Pacific to acquire a majority of shares of the Northern Pacific Railway, which shares were exchanged for shares of the Northern Securities Company; that shares of the Northern Securities Company were subsequently exchanged for shares of Great Northern and Northern Pacific, and that, though a certain amount had been disposed of, a large amount of these shares of Great Northern and Northern Pacific were still owned, "which said shares, and each and all of them, were illegally held by said Oregon Short Line Railroad Company as the agent and representative of said conspirators, and are held pursuant to said conspiracy and not otherwise"; that the defendant Clark and certain associates incorporated the San Pedro, Los Angeles and Salt Lake Railroad Company to build an independent, competing line from San Pedro, through Los Angeles to Salt Lake City, and that the defendants, Harriman, Schiff, Kahn, Stillman, the Union Pacific Railroad and the Oregon Short Line,

"for the sole purpose of restraining trade and commerce among the States and with foreign nations and monopolizing the same as hereinbefore more particularly set forth and of preventing competition between said railway so in the process of construction, and said Union Pacific Railroad system, including the said Southern Pacific system," by means of "threats, litigation and other interference," succeeded in inducing Clark and his associates "to desist from and abandon their proposed independent competing line," and that "said Harriman and his associates hereinbefore named and said Oregon Short Line Railroad Company on the one part, and the said Clark and his associates upon the other part, combined and confederated together to suppress such proposed competition," with the result that "in pursuance of the said combination, confederation and conspiracy," there was no competition between the San Pedro, Los Angeles and Salt Lake Railroad and the lines controlled by Harriman; and finally that "pursuant to said conspiracy," the defendants, Harriman, Schiff, Kahn, Stillman, Rogers and Frick, had made large purchases of Santa Fé stock, and that the defendants Rogers and Frick, who were directors of the Union Pacific, were directors of the Santa Fé.

The complaint asked the court to grant relief by perpetually enjoining the Union Pacific, the Oregon Short Line, the Oregon Railroad and Navigation Company, or any officers or directors of these companies, from "purchasing, acquiring, receiving, holding, voting (whether by proxy or otherwise), or in any manner acting as the owner of the shares of the capital stock of either the Northern Pacific Railway Company, the Great Northern Railway Company, the San Pedro, Los Angeles and Salt Lake Railroad Company, the Atchison, Topeka and Santa Fé Railway Company, and the Southern Pacific Company." The government also asked that the five railway companies last mentioned¹³ "be perpetually enjoined

¹³ The Northern Pacific Railway Company, the Great Northern Railway Company, the San Pedro, Los Angeles and Salt Lake Railroad Company, the Atchison, Topeka and Santa Fé Railway Company, and the Southern Pacific Company.

from in any manner recognizing or accepting the said Union Pacific Railroad Company, the Oregon Short Line Railroad Company, the Oregon Railroad and Navigation Company, or any person or corporation whatsoever, in their interest or in the interest of any one of them, as the owner or holder of any shares" of the capital stock of the companies named.

Progress of the Suit; Death of Harriman

After the different defendants made their answers to the complaint, a special examiner was appointed to take testimony. Hearings commenced in the late fall of 1908. The taking of testimony was not completed until April, 1910. Hearings were held in different parts of the country, and the evidence covers somewhat the same ground as that taken in 1907 by the Interstate Commerce Commission, but is very much more detailed and voluminous. The important facts which came out at the different hearings have already been considered, so that it is not necessary to discuss them here. Before the testimony was closed, the Union Pacific sold its shares of Santa Fé stock, and its remaining shares of Great Northern and Northern Pacific, thus ending the "community of interest" relations which it had with those two companies.¹⁴ The question of "restraint of trade" was therefore now involved only in the Union Pacific's stock interest in the Southern Pacific and in the San Pedro, Los Angeles and Salt Lake Railroad.

While these hearings were still in progress, Harriman died, in September, 1909, at his home in Arden, New York. Judge Robert S. Lovett, who had been general counsel of the Harriman roads, was chosen to succeed him as president of each of the allied lines. Lovett remained the president of the Union Pacific Railroad until recently.

After the testimony had all been taken the suit to dissolve the Union Pacific-Southern Pacific combination was argued before the circuit court early in 1911.¹⁵

¹⁴ Annual Reports.

¹⁵ See *United States v. Union Pacific Railroad et al.*, 188 Fed. 102.

The geographical situation of the Union Pacific and Southern Pacific, and the extent to which these two lines were actually competitors prior to the combination has already been considered, and this question is not therefore discussed here. The case of the defendants depended to a considerable extent upon the meaning of the word "competition." The railroads claimed that since a road could not compete with its connections, the Union Pacific and Southern Pacific could not be classed as competitors; that the Southern Pacific was not a competitor of its own connecting lines, either at New Orleans, El Paso, or Ogden; that two independent lines cannot be said to be competing in a direct sense, as distinguished from some indirect and "limited" sense, unless they are related by common terminals; that the Union Pacific was not, therefore, a competitor of the Sunset Route, and that the amount of actual competitive business was so small as to be inconsequential. Attorneys for the railroads also further argued that the restriction of competition, if any, must be direct, not remote; substantial, not incidental, or relatively unimportant; and undue and unreasonable; and the combination of the Union Pacific and Southern Pacific, if it restrained trade at all, did not constitute an unreasonable restraint of trade.

Decision of the Supreme Court

Such, in brief, was the case of the railroads. In 1911 the circuit court upheld the validity of the Union Pacific-Southern Pacific combination.¹⁶ The government thereupon appealed to the United States Supreme Court. The case was argued before the Supreme Court in April, 1912, and the decision of the court in favor of the government was announced on December 2, 1912. The Supreme Court decided:¹⁷

1. That a combination of railroads which places a single dominating control in one corporation, so that compe-

¹⁶ See *United States v. Union Pacific Railroad et al.*, 188 Fed. 102.

¹⁷ *United States v. Union Pacific Railroad Company et al.*, 226 U. S. 61, 33 S. Ct. 53, 57 L. Ed. 124.

tion is unduly restricted or suppressed, constitutes a violation of the Sherman Act, whether the result is accomplished through a holding company, or through direct transfer of a dominating stock interest from one to the other.¹⁸

2. That a purchase by one railway company of stock in a competing road, though legal under its charter, comes within the inhibition of the Anti-Trust Act.
3. That the acquisition of the Southern Pacific by the Union Pacific was an illegal combination, since the two systems were competitors for business large in volume, though small in comparison with the total traffic carried.
4. That the federal district court¹⁹ should enjoin the Union Pacific, or any corporation or person in its interest, from voting its stock of the Southern Pacific, and from making any transfer which might continue the Union Pacific control; and that the district court enjoin the payment of dividends on Southern Pacific stock while it was still held by the Union Pacific, except to a receiver appointed by the court.
5. That "any plan for the disposition of the shares of stock of the Southern Pacific Company, found by the Federal Supreme Court to have been acquired by the Union Pacific Railroad Company, contrary to the act of July 2, 1890, prohibiting combinations in the restraint of interstate trade, must be such as effectively to dissolve the unlawful combination, and must be subject to the approval and decree of the district court, which shall proceed, upon the presentation of any plan, to hear the government and the defendants, and may bring in any additional parties whose presence may be necessary to a final disposition of the stock in conformity to the views of the Supreme Court."

¹⁸ The railroads contended that the Union Pacific-Southern Pacific combination differed from the Northern Securities combination in that the Union Pacific controlled the Southern Pacific directly, while the Northern Securities Company had been a holding company.

¹⁹ United States Circuit Courts were abolished in 1911, and their jurisdiction conferred upon United States District courts. This change took effect January 1, 1912. (Act of March 3, 1909, 36 Stat. L. 1167.)

6. That the decision was not to be construed as prohibiting the Union Pacific from retaining the Central Pacific line from Ogden to the coast if the latter line were separated from the Southern Pacific system; or from retaining the San Pedro, Los Angeles and Salt Lake Railroad.
7. That three months be allowed for the submission to the district court of plans for dissolving the combination, failing which the court should dispose of the stock by receivership and sale.

Attempt to Retain Central Pacific

This decision affected the relation of the Union Pacific and Southern Pacific only. The Union Pacific's interest in the San Pedro, Los Angeles and Salt Lake Railroad was left undisturbed.²⁰ The first plan suggested as a means for carrying out the court's decree was that the Union Pacific sell its shares of Southern Pacific to stockholders of the Union Pacific, in proportion to their holdings, or distribute these shares among its stockholders as a dividend. A motion to this effect was submitted to the United States Supreme Court on December 9, 1912. On January 6, 1913, the Supreme Court rejected this plan.

We are of the opinion, however, and now hold that the proposed plan of disposition of the entire stock holdings of the Union Pacific Co. in the Southern Pacific Co. by transfer to the stockholders of the Union Pacific Co. will not so effectually end the combination as to comply with the decree heretofore ordered by this Court to be entered.²¹

Upon the failure of the Supreme Court to accept the above plan for the dissolution of the two companies, a new plan was formulated, which was announced early in February, 1913. This plan was in substance: that the Southern Pacific stock owned by the Union Pacific, amounting in all to \$126,650,000

²⁰ The name of this road has very recently been changed to the Los Angeles and Salt Lake Railroad.

²¹ *United States v. Union Pacific Railroad Company et al.*, 226 U. S. 470, 33 S. Ct. 162, 57 L. Ed. 306.

par value out of a total of \$272,672,405 par value, was to be offered to stockholders of the Union Pacific and Southern Pacific (other than the Union Pacific and the Oregon Short Line) for subscription at 98 $\frac{5}{8}$ per cent and accrued dividend; that the proceeds of \$84,675,500 of this stock, less the underwriting commissions and expenses, be paid over to the Southern Pacific Company, together with \$5,449,000 in the Southern Pacific's 4 per cent gold bonds and \$14,065,441 in cash; that in return the Southern Pacific turn over to the Union Pacific the entire capital stock of the Central Pacific, consisting of \$67,275,500 par value of common and \$17,400,000 par value of preferred.²²

This plan was submitted to the United States district court; but in order that it might be carried out it was in the opinion of the counsel of the Union Pacific Railroad necessary or desirable that the plan have the approval of the California Railroad Commission. This Commission, however, objected to many minor features of the proposed plan whereby the Union Pacific would acquire the Central Pacific from Ogden to the coast. In a telegram to the Attorney-General of the United States, the Commission objected "to the breaking up of the local system of the Southern Pacific within the state of California into two dissociated local systems, with attendant inconvenience to shippers," and suggested that the design of divesting the Southern Pacific of a line from the coast to Ogden could be brought about equally well by "a lease by the Union Pacific of the main line of the Central Pacific from Ogden to Sacramento, and thence via Stockton and Niles to Oakland, thus leaving the Southern Pacific in control of the local system within the State of California."

Both the Union Pacific and Southern Pacific endeavored to work out some plan which would be satisfactory to the

²² The original plan was to turn over to the Southern Pacific \$84,675,500 Southern Pacific stock, \$5,449,000 in Southern Pacific bonds owned by the Union Pacific, and \$14,065,441 in cash. The plan was modified because of legal doubts regarding the right of the Southern Pacific to acquire its own shares. (Chron. 96: 421 [1913].)

Commission, and certain modifications in respect to trackage rights and joint terminals were made to the plan in the expectation that these modifications would meet the approval of the California Railroad Commission. The Commission, however, withheld its approval. The plan for the acquisition by the Union Pacific of the Central Pacific was definitely abandoned in March, 1913.²³

It is difficult to understand why the California Railroad Commission was opposed to a plan whereby the Union Pacific should acquire the Central Pacific line to California. The grounds on which its objection was based seem trivial. The "monopoly" which existed in the Union Pacific-Southern Pacific combination lay chiefly in the fact that the Southern Pacific Company owned three out of the five rail approaches to California and was also without serious competition in regard to the local traffic of the state. The preponderating sentiment of the state of California has been and is antagonistic to the Southern Pacific Company. An opportunity was here offered for the Union Pacific to enter the state as a competing line of the Southern Pacific, and this opportunity was cast aside by the California Railroad Commission. The plan proposed by the Union Pacific and Southern Pacific bore every indication of having been made in good faith, and of being a practical as well as a sound economic solution of the situation, and the position taken by the California Railroad Commission is therefore the more inexplicable. How far the position of the Western Pacific and in what manner that company may have influenced the situation is not known.²⁴

²³ See Chron. 96: 655 (1913), and Chron. 96: 865 (1913).

²⁴ In 1911, the Western Pacific was completed as a part of the Missouri Pacific-Denver and Rio Grande system, from Salt Lake City to San Francisco. This road, though not a party to the proceedings relating to the Union Pacific and Southern Pacific, interposed two objections to the plan. The Western Pacific objected to the application of the Union Pacific for an exclusive lease of the new line of the Southern Pacific from Oakland to Sacramento via Benicia, known as the Benicia Short Line, a line which would save the Union Pacific 80 miles into Oakland. The original Central Pacific line between Sacramento and San Francisco went by way of Stockton and Niles somewhat to the south of the new Short Line. The Commission held that if the Southern Pacific granted the Union Pacific the use of the Short Line it should accord all competing carriers like privileges on similar terms. The Western Pacific also objected to a provision in the proposed arrangement giving the Central Pacific in

After the failure of this plan, the Union Pacific asked that the time limit for the formulation of a plan of dissolution be extended to July 1, 1913. This extension was granted. Efforts were made to formulate a new plan which should include the transfer of the Central Pacific to the Union Pacific; but it finally became apparent that no arrangement could be made which would be satisfactory to both the Union Pacific and the Southern Pacific, and at the same time satisfactory to the government, the California Railroad Commission, and of certain foreign creditors of the Southern Pacific whose consent was necessary by reason of certain provisions of a collateral trust indenture made by the Southern Pacific.²⁵

Plan of Dissolution

The plan finally formulated and adopted was as follows: that \$38,292,400 of Southern Pacific stock owned by the Union Pacific be exchanged for \$42,547,300 of Baltimore and Ohio stock owned by the Pennsylvania lines; this exchange to be consummated within twenty days from the decree; that the remaining \$88,357,600 of Southern Pacific stock owned by the Union Pacific be deposited with a trust company, to be appointed by the court; that the Union Pacific and Oregon Short Line offer to their stockholders, preferred and common, the right to subscribe to certificates of interest representing the Southern Pacific shares deposited with the trustee, this offering to include all accumulated dividends and to be at such price and upon such terms as the Union Pacific should determine, but that neither the Union Pacific, the Oregon Short Line, or any corporation controlled by either be permitted to acquire the said certificates of interest; that these certificates of interest be negotiable, and that the holder of a full-paid certificate might at any time prior to January 1, 1916, by

Southern Pacific territory and the Southern Pacific in Central Pacific territory the right to the use of the terminals and commercial tracks of the owning company. The Railroad Commission sustained the Western Pacific in both objections, and objected to certain other minor features of the proposed arrangement.

²⁵ Chron. 96: 1558 (1913).

presenting and surrendering the same to the trustee receive the number of shares of Southern Pacific stock represented thereby, together with all dividends thereon, beginning with that of April 1, 1913 (but without interest), but only upon the express condition that he make an affidavit in the form prescribed, showing in substance that he was not the owner of any shares of stock of the Union Pacific, that he was "making the application in his own behalf," and that he was "not acting for or on behalf of any stockholders of the Union Pacific Company or in concert, agreement or understanding with anyone seeking to control the Southern Pacific Company in the interest of the Union Pacific Company"; that if any certificates of interest should still be outstanding on January 1, 1916, the trustee was to sell the stock represented thereby and pay the proceeds to the lawful holders.²⁶

This plan was approved by the court on June 30, 1913. Its effect, according to the Attorney-General, Mr. McReynolds, would be to vest in the Union Pacific the ownership of about 38.66 per cent of the stock of the Baltimore and Ohio²⁷ and to vest in the Pennsylvania the ownership of about 14 per cent of the stock of the Southern Pacific Company. One feature of the plan was that it would destroy the stockholding relations then existing between the Pennsylvania and the Baltimore and Ohio, a relation which was objectionable since these two systems were competing lines. Pursuant to the arrangement the Union Pacific offered to its stockholders the right to subscribe to the extent of 27 per cent of their holdings for these certificates of interest in the 883,576 shares of Southern Pacific stock, par value, \$88,357,600, deposited with the trustee. The price of subscription was \$92 a share, that is, \$88 a share and accrued dividends. Certificates of interest amounting in all to \$88,357,600 were issued, this sum being

²⁶ Chron. 97: 50 (1913).

²⁷ This included the stock already owned by the Union Pacific in the Baltimore and Ohio.

the par value of the Southern Pacific stock deposited with the trustee.²⁸

Extra Dividend

The plan was carried out as intended. Considerable speculation developed regarding what disposition the Union Pacific would make of the proceeds from the sale of the above-mentioned certificates of interest. Rumors of an extra dividend were general. The cash proceeds from the sale of these certificates of interest were, however, "temporarily invested in railroad bonds, equipment trust obligations, short term railroad notes and secured loans, which, while affording a reliable income, can be converted into cash when needed."²⁹ Later, in January, 1914, the Union Pacific declared an extra dividend, as follows: Each holder of one share of Union Pacific common stock received:

	PAR VALUE		YIELDING
Baltimore and Ohio preferred.....	\$12.00	at 4%	\$.48
Baltimore and Ohio common.....	22.50	at 6%	1.35
Cash	3.00	at 6%	.18
	<hr/>		<hr/>
	\$37.50		\$2.01

The regular annual dividend rate was reduced at the same time from 10 to 8 per cent per annum. The distribution of the Baltimore and Ohio stock was made to meet the expectations of shareholders; to avoid criticism for holding stock in a competing line, since the Union Pacific owned \$17,857,100 of New York Central stock; and "to effect the reduction in the annual dividend rate, 10 per cent being considered an undesirably high rate in view of the present attitude of railway and state legislation."³⁰

²⁸ Of the Oregon Short Line's issue of 4 per cent refunding bonds (see pp. 281-2) the Union Pacific held \$55,000,000. The Union Pacific canceled these \$55,000,000 of Oregon Short Line bonds, and thus released the shares of Southern Pacific stock which had been pledged as part collateral to secure the payment of the entire issue of \$100,000,000.

²⁹ Annual Report, 1914.

³⁰ Chron. 98: 157 (1914).

It was intended that this extra dividend be paid April 1, 1914, but owing to litigation in the New York State courts the payment was deferred. This litigation was instituted by the Equitable Life Assurance Society for the purpose of enjoining the payment of the extra dividend upon the common shares, since the preferred shareholders were excluded from participating in this dividend. The injunction was, however, denied. On May 1, 1914, the Appellate Division of the Supreme Court of New York upheld the right of the company to pay this extra dividend to its common shareholders.³¹ Upon appeal to the New York Court of Appeals, the Court of Appeals affirmed the action of the lower court and denied the motion of the Equitable Life Assurance Society to enjoin the company from distributing this extra dividend.³²

The dividend was paid July 20, 1914. The amounts distributed were as follows:³³

	PER SHARE	TOTAL DISTRIBUTED	TOTAL OWNED BY UNION PACIFIC
Baltimore and Ohio preferred.....	\$12.00	\$26,674,005	\$28,480,000
Baltimore and Ohio common.....	22.50	50,013,765	53,607,800
Cash	3.00	6,668,502	.....

During the five years from 1909 to 1914, the Union Pacific system had constructed additional branches and feeders. One of the most important of these feeders was a new line from Portland to Seattle, which was completed early in 1910. This road, the Oregon and Washington Railroad, together with a number of other subsidiary corporations of the Union Pacific system owning lines in the region of the Pacific northwest, was consolidated in December, 1910, with the Oregon Railroad and Navigation Company. The new subsidiary corporation thus organized became known as the Oregon-Washington Railroad and Navigation Company. At the close of the year

³¹ *Equitable Life Assurance Society v. Union Pacific Railroad Company*, 162 App. Div., 81; 147 N. Y. Supp. 382.

³² *Same case*, 212 N. Y., 360, 106 N. E. 92.

³³ Chron. 99: 200 (1914).

1914, the Union Pacific system consisted of the Union Pacific Railroad Company, the Oregon Short Line Railroad Company, the Oregon-Washington Railroad and Navigation Company, some other subsidiary corporations, and a half-interest in the San Pedro, Los Angeles and Salt Lake, or, as it is now known, the Los Angeles and Salt Lake Railroad.

CHAPTER XIV

RECENT OPERATIONS

Return on the Company's Property Investment

The fiscal year ending June 30, 1915, showed a marked falling off in revenue. The increased business stimulation consequent upon the European War had not become felt, and a general business depression was reflected in railroad earnings. The net operating income of the Union Pacific decreased to \$30,180,106.06, and the net income from all sources, not deducting fixed charges, decreased to \$43,483,267.22.¹ The strong financial position of the company, however, enabled it to meet its obligations and dividend payments with ease, although many other railroad companies were entering upon a prolonged period of financial difficulties.

The following fiscal year, ending June 30, 1916, brought an unprecedented revival of business, and in that year the gross operating revenues of the Union Pacific were reported at \$104,717,005.06, the largest in the company's history.² Net income from operations increased to \$40,918,905.51, and net income from all sources, not deducting fixed charges, increased to \$52,670,649.28.³

The continued prosperity of this company must, in large part, be attributed to the results of the policy of the management during the first decade following the reorganization, and especially to the continued reinvestment of earnings in extensive physical improvements and in maintenance, during the prosperous years of the early part of the twentieth century. It is a matter of common knowledge that many railroads have met with financial difficulties in recent years because of the

¹ Annual Report for 1915, p. 8.

² *Ibid.*, 1916, p. 8.

³ *Ibid.*

great increase in operating expenses, notwithstanding heavy business and large gross operating revenues. It cannot be controverted that, whatever the underlying cause or causes, the return on railroad investments has been small in recent years, apart from any questions of the effect upon railroads, of financial organization, stock manipulations, and other wholly artificial factors. In the case of the Union Pacific, although the percentage return upon its property investment is relatively low compared with other industries, yet such return is materially higher, and has been higher than in the case of the great majority of American railroads, while, irrespective of the relative percentage of return, the absolute figures of net income might suffer considerable decrease and yet not endanger the company.

The company's annual report for 1916 contains a statement as to the percentage of return for the six years from 1911 to 1916, inclusive, and such return upon the property investment is given at the following figures:⁴

YEAR	PERCENTAGE OF RETURN
1911.....	7.15
1912.....	5.87
1913.....	6.32
1914.....	5.63
1915.....	5.32
1916.....	7.17

These percentages are without reference to the division of the return on the investment as between the bondholders and stockholders, or as between the several classes of bondholders and the two classes of stockholders. Moreover, no account is taken of the income from investments, these percentages reflecting merely the net operating income of the company from its business as a common carrier of freight and passengers.

It should also be observed that the policy of extensive maintenance has been continued since the dissolution of the

⁴ Annual Report for 1916, p. 9.

Union Pacific and Southern Pacific combination. Numerous items which had formerly been charged against income were and are, under present regulations of the Interstate Commerce Commission, charged to capital.⁵ While a definition of what is a fair return is not within the scope of this work, the following statement of the company in this connection cannot be said to be without foundation.⁶

This (the percentage of return) indicates that even in the most prosperous years the return upon the property employed in transportation service is not large; and considering the absolute necessity of expending large amounts out of surplus each year for improvements classed as "additions and betterments" by the Interstate Commerce Commission, but which do not appreciably increase revenue or reduce expense, the net return on the railroad investment is certainly not an excessive price for the public to pay for the use of these properties.

Additions and Betterments; Adamson Law; Increased Dividend Rate

After 1915, that class of maintenance expense, which under accounting regulations of the Interstate Commerce Commission was not chargeable against income, was nevertheless not reflected as a credit to the general surplus account. A new account was set up,⁷ and referred to as "Appropriated Surplus," this account representing expenditures for betterments and other like purposes, which, however, were not of such sort as to increase revenues.

Between 1908 and 1914, inclusive, it is reported by the company⁸ that a total of \$167,144,929.00 had been expended for additions, betterments, double track, equipment, extensions and branches, but that this expenditure did not appreciably add to revenues, and so was during those years charged to income. A fair consideration requires the conclusion, upon

⁵ Annual Report for 1916, p. 17.

⁶ *Ibid.*, p. 9.

⁷ *Ibid.*, p. 17.

⁸ *Ibid.*, p. 18.

the basis of all the evidence, that the property account of this company is not inflated, and that it represents an actual investment.

The fall of the year 1916 was marked by the passage of the so-called Adamson Eight-Hour Law,⁹ passed at the demand of President Wilson to avert the then threatened nationwide strike of railway employees. It is beyond the scope of this work to discuss the effects of this legislative interference with the pay and working conditions of the railway employees. The act had far-reaching consequences, not so much because of immediate results, but because the precedent was established of yielding to insistence and of enacting economic legislation under the stress of political expediency. The statute was sustained by the United States Supreme Court.¹⁰

In 1916 the company changed its fiscal year to correspond with the calendar year, thus restoring the accounting periods that had been in use prior to the reorganization.

In 1917 the annual dividend on the common stock was increased from 8 to 10 per cent,¹¹ at which rate it still remains. In the same year the entire surplus for the year remaining after the payment of dividends was appropriated to expenditures made under the Interstate Commerce Classification, "Investment in Road and Equipment." This, the company explains, was deemed expedient because of the Revenue Law of October 3, 1917,¹² which imposed a tax of 10 per cent on undistributed corporate net income unless invested or employed or retained for employment in business or invested in government bonds. The company reported that more than this surplus had been so spent during the year, and that the specific allocation was made to make the bookkeeping conform to the facts.¹³

⁹ Act of Sept. 3, 5, 1916, 39 Stat. L. 721.

¹⁰ *Wilson v. Neu*, 243 U. S. 332, 37 S. Ct. 298, 61 L. Ed. 755.

¹¹ Annual Report for 1917, p. 8.

¹² Section 1206, 40 Stat. L. 300, 334.

¹³ Annual Report for 1917, p. 8.

Operation by Railroad Administration

The end of the year 1917 marked the beginning of a new epoch in the history of this company, as indeed in the history of American railroads. The United States had declared the existence of a state of war with Germany, on April 6, 1917.¹⁴ The increased activities following American entry into the war had put a strain upon the country's railroads, and it was deemed necessary for the President to take them over. Pursuant to authority conferred by congressional enactment, the railroads of the country were so taken over by executive proclamation effective December 28, 1917, at noon, except for accounting purposes, for which the effective date was December 31, 1917, at midnight. The President appointed W. G. McAdoo, the Secretary of the Treasury, to the newly created office of Director-General of Railroads; and an agency for federal operation was set up known as the United States Railroad Administration.

Under the terms of the so-called Federal Control Act,¹⁵ the United States undertook to pay to the several companies, as rental, an annual sum not exceeding the average annual net railway operating income for the three preceding years, ending June 30, 1917, this period being denominated the "test period," and the amount of such average income being termed the "standard return." This rental was to be increased by a reasonable percentage on betterments and extensions, with the approval or by order of the President. Federal war taxes were to be paid by the several corporations; all others were assumed by the United States.

The Union Pacific presented a claim for additional rental, based upon betterments charged to earnings after the test period, or so late in it as not to be reflected in the standard return. This claim was denied by the Railroad Administration, on the ground that the standard return was not "plainly

¹⁴ Joint Resolution of April 6, 1917, 40 Stat. L. 1..

¹⁵ Act of March 21, 1918, 40 Stat. L. 451.

inequitable." As the company was confronted with the alternative of litigation or acceptance of the standard form of contract, it chose the latter alternative, and dropped the claim for a higher compensation.¹⁶

The rental paid by the United States for 1918 amounted to \$38,416,110.79. After making certain deductions, representing federal taxes and incidental expenses, the net income of the company from operations amounted to \$35,356,790.79,¹⁷ as compared with \$43,737,767.54 for the calendar year 1917,¹⁸ and \$44,833,837.87 for the calendar year 1916.¹⁹ On the other hand, the net earnings of the railroad during the year 1918 amounted to \$50,822,110.01,²⁰ or about \$12,000,000 in excess of the rental paid by the United States, which excess inured to the benefit of the government.

The total net receipts from traffic carried by it during 1918 were larger than the net income of the company at any period in its history, due to the fact that the Union Pacific was the shortest line between the west coast and Chicago, and, further, by reason of its easy grades, double track, and excellent maintenance, it was the most convenient route for the heavy volume of congested traffic. It was the natural route for through traffic, and the long policy of maintenance had made this road able to handle the increase. The Union Pacific was one of the few railroads on which the United States government, during the period of federal operation, realized a substantial profit over and above the annual rental paid.

The first bonds the company had placed on the market since 1912 were sold in 1918, when \$20,000,000 of 6 per cent gold bonds were issued to reimburse the Treasury for expenditures for additions, betterments, and equipment during 1917.²¹

In the year 1919, the gross receipts from the traffic carried increased further, and amounted to \$177,447,698.07, the

¹⁶ Annual Report for 1918, pp. 7, 8.

¹⁷ *Ibid.*, p. 9.

¹⁸ *Ibid.*, 1917, p. 8.

¹⁹ *Ibid.*, 1916, p. 8.

²⁰ *Ibid.*, 1918, p. 12.

²¹ *Ibid.*, p. 15.

largest in the company's history. The net receipts from traffic in the same year amounted to \$47,139,801.38.²² The rental paid by the United States was slightly increased because of certain adjustments, and amounted to \$39,369,410.92. The profit to the government from this road during 1919 was therefore in excess of \$15,000,000. After corporate expenses and taxes were deducted, the company's net return, as the lessor of its railroad properties, amounted to \$34,419,213.52.²³ The large increase in gross and net earnings, to the United States, as lessee of the Union Pacific, was attributed, in the company's annual report, to increased rates that were made effective in the summer of 1918.²⁴

The Esch-Cummins Law

After the termination of hostilities, on November 11, 1918, the question of the return of the railroads to private ownership became important. After a period of uncertainty, the railroads were restored to the companies at 12:01 A. M. March 1, 1920. The return of these properties was determined by Congress in the so-called Esch-Cummins Transportation Act of 1920,²⁵ which provided, among other things, that the railroad properties were to be returned to their owners March 1, 1920; that the government would guarantee to the several companies a return equal to existing rentals, for the period of six months from March 1, 1920, and that the Interstate Commerce Commission have the power to designate rate groups, and to fix rates which would, in any group, yield a fair return upon the railroad aggregate property value. It was further provided that:

. . . . during the two years beginning March 1, 1920, the Commission shall take as such fair return a sum equal to 5½ per centum of such aggregate value, but may, in its discretion, add thereto a sum not exceeding one-half of one per

²² *Ibid.*, p. 7.

²³ *Ibid.*, p. 5.

²⁴ *Ibid.*, p. 9.

²⁵ Act of February 28, 1920, 41 Stat. L. 456.

centum of such aggregate value to make provision in whole or in part for improvements, betterments, or equipment, which according to the accounting system prescribed by the Commission, are chargeable to capital account.²⁶

This Transportation Act contains the following naïve recognition of the problem raised by the fact that two railroads operating in the same rate group may show widely divergent percentages of return upon their aggregate property value.²⁷

Inasmuch as it is impossible (without regulation and control in the interest of the commerce of the United States considered as a whole) to establish uniform rates upon competitive traffic which will adequately sustain all the carriers which are engaged in such traffic and which are indispensable to the communities to which they render the service of transportation without enabling some of the carriers to receive a net railway operating income substantially and unreasonably in excess of a fair return upon the value of their railway property held for and used in the service of transportation, it is hereby declared that any carrier which receives such an income so in excess of a fair return, shall hold such part of the excess as hereinafter prescribed, as trustee for, and shall pay it to the United States.²⁸

It is then provided that of any income received by a carrier in excess of 6 per cent upon the aggregate property value, one-half shall be retained by the carrier as a reserve fund, and the other one-half shall be paid to the United States, to be used as a "general railroad contingent fund," and used for the purpose of making loans to carriers applying therefor, upon terms and conditions fixed by the Interstate Commerce Commission.²⁹ Elaborate provisions for advances to carriers were also incorporated in the act. The act also contained provisions for the hearing and determination of labor dis-

²⁶ Section 422, adding to Interstate Commerce Act, Section 15a, subsection (3), 41 Stat. L. 488.

²⁷ *Ibid.*, subsection (3), 41 Stat. L. 489.

²⁸ *Ibid.*, subsections (6) to (8), 41 Stat. L. 489.

²⁹ *Ibid.*, adding to Interstate Commerce Act, Section 15a, subsection (10) ff., 41 Stat. L. 490 ff.

putes, and for that purpose set up a Railroad Labor Board. Numerous other novel features were enacted, the discussion of which, however, is beyond the scope of this work.

This statute was intended to ward off the feared or threatened insolvency of many of the railroads of the country and it was hoped that the act would have a beneficial influence upon railroad finances. However, the statutory attempt to cover the matter of "fair return" further complicates an already complicated problem, and in attempting solution, the aim seems to be to standardize the return to 6 per cent upon the property investment and to fix this percentage as an arbitrary limit. The intent seems to be to assure a "fair return" irrespective of economic conditions or questions of management; while, on the other hand, the incentive of reward to efficient and able management is removed, in thus fixing this arbitrary limit. Popular outcry has been directed at limiting or attempting to limit profits arbitrarily; and this feeling is reflected in this statute, which provides for this limit instead of recognizing the principle that the return or profit is usually irrelevant and that the important problem is to fix and determine upon a fair and reasonable rate, and, this having been done, leave the question of profit, or of loss, to be regulated by normal economic forces, efficiency of management, law of supply and demand, and like factors. This principle of the Esch-Cummins Law is unsound and must be condemned as one which would penalize the ably and conservatively managed railroad for the benefit of weak, overcapitalized and badly maintained systems. By reason of the fact that high operating costs, for labor and for material, have followed the close of the European War, the percentage of return, even in the case of strong roads like the Union Pacific, has not exceeded 6 per cent upon the aggregate property value; and this question has thus far not been pressed. But in the event of a period of reduced expenses, or of increased railway revenues, the matter would immediately assume a most important aspect

The Union Pacific, by reason of its excellent maintenance and its financial strength—a condition that has resulted, not from mere fortuitous circumstances, but is mainly due to many years of able management—would be one of the first railroads to be required to pay over its surplus earnings to this so-called “contingent fund.” The Union Pacific has earned more than 6 per cent in a number of recent years, and there is every expectation that it may again do so. For the calendar year 1916, as distinguished from the fiscal year ending June 30, 1916, the percentage is given at 7.78 per cent, and for the fiscal and calendar year 1917 the percentage was 7.33 per cent.³⁰ If the earnings under government control, in 1918 and 1919, be considered, the return would be even higher.

The probable attitude of the company toward this provision of the Esch-Cummins Law is thus indicated in the Annual Report for 1919:³¹

The provision above noted, requiring every carrier which earns more than six per cent of the value of its properties to pay over to the Government one-half of the excess, is a radical departure in the policy of the National Government with respect to railroad capital since for the first time it limits the returns which a railroad company may earn and save for its owners out of transportation rates which the Government itself fixes or authorizes. Many eminent lawyers are of opinion that this confiscatory provision is unconstitutional and doubtless its validity will be tested when its enforcement is undertaken. One of the evils of it is already apparent when even the strongest railroad companies are faced with the necessity of paying over seven per cent for money with which to provide equipment and other facilities needed by the public while limited in their return to six per cent and one-half of anything earned above that rate. The holders of Union Pacific common stock should understand however, that even if the validity of the provision should be sustained by the courts, it does not follow that their dividends would be limited to six per cent. The law does not base the six per cent limitation

³⁰ Annual Report for 1919, p. 16.

³¹ *Ibid.*, p. 5.

upon the stock or bonds or any form of capitalization but upon the *value* of the railway property held for and used in the service of transportation which of course does not include investments in other companies, which in the case of the Union Pacific, yield an annual income of about \$12,000,000.00. Moreover, of the total funded debt outstanding in the hands of the public amounting to \$355,066,170.00, all but \$49,203,500.00 bears interest at the rate of four per cent per annum, the average for the whole being 4.24 per cent; \$99,543,500.00 of the capitalization is represented by preferred stock limited to dividends at four per cent; and there is an aggregate corporate surplus of \$208,959,456.00, of which \$130,965,901.00 is unappropriated Profit and Loss credit balance. Of course the stockholders are entitled to, and the statute does not attempt to deprive them of, the benefit of the lower interest rate on the bonds and of the four per cent dividend rate on the preferred stock, and the income of say \$12,000,000.00 per annum from investments in securities.

Obviously much depends upon the value finally placed upon the railroad property by the Interstate Commerce Commission under the Act of 1913, a work in which it has been engaged for several years but which is still far from finished. In the absence of any such valuations by the Commission it is quite common to assume for the purpose of estimating the "book value" or "Investment in Road and Equipment" account which in case of the Union Pacific should be very conservative as it is less than the value of the property as proven by established earning capacities, even under the low scale of rates in force prior to Federal Control. In fixing the value of the railway property for the purpose of the statute, the very large uncanceled expenditures for additions, betterments, and equipment and for branches and other extensions should be taken into account. It seems safe to assume that the inevitable increase of rates by the Commission to provide the return authorized by the new law upon the value of all the railroads in the country, or upon the value of any group in which the Union Pacific would be placed, will yield at least six per cent upon the value of the Union Pacific's railway property held for and used by it in the service of transportation.

Future developments may result in litigation over the constitutionality of this provision placing this arbitrary limit on

the profits of the several companies. Should this provision be sustained by the courts, it would then be necessary to construe the meaning of the term "fair return," which means, in substance, "net earnings"; and the whole series of disputes and the general uncertainty due to the doubtful meaning of what items are to be considered in arriving at net earnings might reappear and become the subject of protracted litigation, just as in the earlier period of close relations between the government and the Pacific railroad, the phrase "net earnings" had led to frequent lawsuits to determine its meaning.

Thus far the questions suggested have not been raised, the principal attention having been directed to labor features of the act, and to those features which are by many persons regarded as embodying, in substance, a "guaranty," so-called, of a "fair return" upon the capital invested. The operation of the financial clauses of the act has been relatively unimportant in the case of the Union Pacific on account of the strong financial position of the company. The broader aspects of this novel statute and the effect of this statute upon the nation's transportation must be left for future determination.

Post-War Decline of Earnings; Present Condition

After the termination of governmental operation, the Union Pacific experienced a considerable falling off in trans-continental business, due largely to the return to the coast trade of shipping diverted during the war to the Atlantic service; but the total revenue freight carried in 1921 exceeded that carried in 1915 in an amount sufficient, in the opinion of the management, to indicate a "healthy growth."³² Earnings declined, after the termination of federal control, and during the six months following March 1, 1920, the company failed to earn the amount of the rental that had been paid to it by the government. The company had accepted the six months' guaranty of earnings provided by the Esch-Cummins

³² Annual Report for 1921, p. 9.

Act;³³ and its earnings from operations fell below the guaranteed rental by \$4,661,444.06, according to its Annual Report for 1920.³⁴

The Union Pacific, in common with all railroads, was affected by the post-war economic conditions, high interest rates, and the high cost of labor and materials; and in 1921 was affected by the widespread business depression that followed the great business activity during and immediately following the war. In 1921 passenger traffic on the Union Pacific was reported to have fallen off 26.9 per cent, and freight traffic was reported to have declined 30.9 per cent.³⁵ The net income from railroad operations, apart from investments, was reported for 1921 at \$34,226,167.15,³⁶ a sum which was substantially below the rental paid by the government during the period of federal control. During the same year, 1921, the percentage of gross earnings, which was represented by operating expenses, was reported to be 73.53 per cent.³⁷

Recent operating conditions, which have very generally resulted in abnormally high ratios of operating expenses, as compared with gross earnings, have adversely affected all American railroads, and have endangered the solvency of many of them. The existing economic situation is more far reaching than the conditions faced by the old Union Pacific in the eighties and nineties; and existing railroad labor problems are of greater seriousness than ever before in the nation's history. It is therefore interesting to note that, notwithstanding adverse conditions of recent months, the Union Pacific continues to prosper, and the interest charges and dividends upon its securities are well within its earning power. The long period of conservative management and the policy of reinvestment of its surplus earnings have fortified this company against times of

³³ See Section 209. It was provided that the carriers desiring the benefits of the six months' guaranty would be required to account to the government for any earnings above the guaranteed amounts.

³⁴ Annual Report for 1920, p. 5.

³⁵ Annual Report for 1921, p. 6.

³⁶ *Ibid.*, p. 5.

³⁷ *Ibid.*, p. 7.

depression. Even though its net earnings show a decline, and even though its earnings during 1920 and 1921 fell short of 6 per cent upon its property investment, its financial strength is not endangered.

The income figures for the year 1921 were reported as follows:⁸⁸

Operating revenues.....	\$181,445,913.01
Operating expenses.....	131,601,748.57
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Receipts over expenses.....	\$ 49,844,164.44
Taxes	11,720,855.80
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Operating income.....	\$ 38,123,308.64
Other income (rents and incidental operations)	1,795,053.84
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Total	\$ 39,918,362.48
Deductions, rents, hire of equipment, and incidental operations.....	5,692,195.33
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Net income from railroad properties.....	\$ 34,226,167.15
Income from investments.....	13,138,087.96
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Total income.....	\$ 47,364,255.11
Interest on funded debt and miscellaneous charges.	16,063,180.24
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Net, available for dividends.....	\$ 31,301,074.87

Dividends, at 4 per cent, upon the preferred stock for 1921 amounted to \$3,981,740, and dividends, at 10 per cent, upon the common stock for the same year amounted to \$22,229,160.

The company reported that at the close of 1921, its capitalization was as follows:⁸⁹

Common stock outstanding.....	\$222,293,100.00
Preferred stock outstanding.....	99,543,400.00
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Total stock.....	\$321,836,600.00
Funded debt.....	379,665,530.00
<hr/>	
Total capitalization.....	\$701,502,130.00

⁸⁸ Annual Report for 1921, p. 5.

⁸⁹ *Ibid.*, p. 21.

At the close of 1921, the surplus was reported as follows:⁴⁰

Appropriated for additions and betterments.....	\$ 27,550,040.10
Reserve for depreciation of securities.....	50,000,000.00
Funded debt retired through income and surplus...	391,530.62
Sinking fund reserves.....	182,353.22
<hr/>	
Total appropriated surplus.....	\$ 78,123,923.94
Profit and loss.....	149,010,957.24
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Total surplus	\$227,134,881.18

Purchase of the "Salt Lake" Line

During the year 1921, the Union Pacific obtained the complete ownership of the Los Angeles and Salt Lake Railroad, formerly the San Pedro, Los Angeles and Salt Lake Railroad. This line, as has already been explained, was owned jointly by the Harriman-Union Pacific interests and the so-called Clark interests.⁴¹ The Union Pacific management on April 27, 1921, reached an agreement with Senator Clark for the transfer of the remaining stock of this road at the price of \$20 per share for the stock; and for the bonds it was agreed that the Union Pacific turn over an equal amount of 4 per cent bonds owned by it.⁴² Of the bonds so given by the Union Pacific in exchange, 50 per cent were Oregon-Washington Railroad and Navigation Company 4 per cent bonds; 30 per cent were Southern Pacific first and refunding mortgage 4 per cent bonds; and 20 per cent were Southern Pacific San Francisco Terminal first mortgage 4 per cent bonds. By this exchange, substantially all the bonds of the Los Angeles and Salt Lake were acquired.

The purchase appears to have been on favorable terms for the Union Pacific. The management of the Union Pacific admitted that the fact of its ownership of one-half of the stock "undoubtedly affected the price paid therefor."⁴³ The purpose

⁴⁰ *Ibid.*, p. 21.

⁴¹ *Supra*, Chapter XIII.

⁴² Annual Report for 1921, p. 15.

⁴³ *Ibid.*, p. 15.

and effect of the purchase was to bring this property under the unified management of the Union Pacific system. The Union Pacific now has an entrance to southern California over its own rails, and its position with reference to securing the business of this section is correspondingly improved.

Whether the policy of expansion that was so conspicuous a feature of the Harriman management will reappear is an interesting subject of speculation. The United States Supreme Court has recently held that the ownership by the Southern Pacific Company of the Central Pacific line from Ogden to the coast is contrary to the Anti-Trust statutes;⁴⁴ but the matter is not wholly determined, the railroad having petitioned for a rehearing. If the Central Pacific is separated from the Southern Pacific, it would seem that there is great likelihood that this Central Pacific line might ultimately become a part of the Union Pacific system.

⁴⁴ *United States v. Southern Pacific Company et al.*, — U. S. —, 42 S. Ct. 496, 66 L. Ed. 574. Notwithstanding the decision, efforts have been and are being made to have the combination continued, pursuant to the consolidation provisions of the Esch-Cummins Act. The United States Circuit Court of Appeals has recently held that the Southern Pacific-Central Pacific combination may continue, but whether this decision will be affirmed is not known at this writing.

CHAPTER XV

GENERAL CONSIDERATIONS

Summary of Union Pacific History

The Union Pacific Railroad Company was incorporated in 1862. It was endowed with a land grant, a right of way, and given a loan of government bonds. It was built by a construction company, the Credit Mobilier. The work of construction was carried on at a time of high prices, and with a rapidity which very much increased the cost and the road's capitalization was almost double its cost. After its completion the road met with varying fortunes until 1898. Its relations with the United States government were of a peculiar nature, and unsatisfactory to both the road and the government. From 1875 until 1884 the Union Pacific paid large dividends upon a watered stock. But no adequate provision was made for the payment of its large debt to the government. Jay Gould acquired control of the road in 1873 and used it to further his speculative schemes, and in the course of his operations the company's capital obligations were swelled by the Kansas Pacific consolidation and by the acquisition, at inflated prices, of the securities of minor lines. In June, 1884, the Union Pacific came under a different management with Charles Francis Adams as president; but the Adams administration was unable to undo the work of former administrations which, besides making large dividend payments and otherwise mismanaging the property, had burdened the road with a capitalization out of all proportion to its physical value and with debts which should never have been assumed. When the Adams management took charge of the Union Pacific, the company was in financial distress, due, as explained, partly to the financial policy of the builders, partly to the operations of Gould

and Sage, and partly to the relations then existing between the government and the railroad. These relations were to a large extent the result of a general feeling of antagonism to the company, an antagonism borne out of the Credit Mobilier disclosures, and out of the policy of the Gould management in paying large dividends without making any preparation to meet the company's debt to the government when the debt should mature. The Adams administration accomplished much towards improving the company's financial position and worked toward bringing about a better understanding between the company and the government. In 1890 Gould again came into control. In 1893 the company was compelled to go into a receivership, which lasted until 1897. In that year the road was sold under foreclosure, the debt to the government was paid off, and a new management came into control. This management, under the control and guidance of E. H. Harriman, made many improvements in the road's physical condition and otherwise strengthened the road. The chief feature of the Harriman policy was, however, the extension of the Union Pacific control over other lines. This extension policy continued until the dissolution of the Union Pacific-Southern Pacific combination in 1913.

The history of the Union Pacific is in some respects typical and in some respects unique. Although it has been only in the case of the Union Pacific and its companion roads, the Central Pacific, the Kansas Pacific, the Central Branch Union Pacific, and the Sioux City and Pacific, that the government issued its bonds to aid in the construction of a railroad, other railroads have received loans or subsidies in the form of county, town, or city bonds. Certain lines in this Union Pacific system received local aid in this form. Land grants have been frequently made by the federal government to aid railroads in the middle west and in the far west, and had been made to other companies before 1862. Of the six American transcontinental railroads—the Great Northern, the Chicago, Milwaukee and

St. Paul, the Northern Pacific, the Union Pacific, the Atchison, Topeka and Santa Fé, and the Southern Pacific—all but two, the Great Northern and the Chicago, Milwaukee and St. Paul, received land grants from the federal government. The general policy of the government towards the Union Pacific was therefore no different in this particular from the government policy toward other roads.

In their relation with the government, the history of the bond-aided Pacific railroads is without a parallel in American railroad development. The relations of the Union Pacific with the government have been peculiarly intimate. The other bond-aided Pacific railroads were state incorporated, while until 1897 the Union Pacific operated under a national charter. The Union Pacific is the one instance in which the experiment of having the government represented in the directorate was attempted. The problems which grew out of the relations of the bond-aided roads with the government have been disposed of. In the case of the Union Pacific, the government was paid in cash the principal of its debt in full, and all but a small portion of the interest. The government's relations with the Union Pacific Railroad have historic interest, and the events which grew out of this relationship, which was created by the acts of 1862 and 1864, have exercised a strong influence upon the thought of the nation in regard to the general railroad problem.

The Union Pacific an Illustration of American Railroad History

In other respects the history of the Union Pacific, itself one of the most important railroads in the United States, may be considered as a fair example of the history of many other railroads. While the history of every road has certain characteristics which are peculiar to that road, the development of each system has many features in common with the development of many, if not a majority, of other systems. Certain

conclusions may therefore be drawn from the history of the Union Pacific in regard to the railroad situation in general.

Many railroads have been aided by land grants. Nearly all railroads built during the period of great railroad construction, that is to say, during the sixties, seventies, and eighties, were built by construction companies, the stockholders of which were themselves promoters of the railroads. After completion, railroads have been managed in many cases with a view to manipulating the stock market rather than with a view to administering them as agencies of transportation. Speculators have by means of consolidations, stock dividends, or other devices, inflated the capitalization of railroads. Often the consequence has in the past been either exorbitant rates, or railroad failures, and in many cases both.

The railroad problem is difficult and complicated. Some of the questions which have arisen since the rapid development of modern transportation have been solved satisfactorily. Since the passage, in 1890, of the amended Interstate Commerce Law, and other later acts, rate discrimination is no longer a problem. The giving of rebates has been brought to an end, notwithstanding the fact that it was at one time believed impossible to restrain this evil practice. The issuance of free passes has been so restrained that it is no longer considered a source of political corruption or a means of bestowing favors. It has become a generally accepted principle that railroads, because they are necessary servants of the public, are subject to federal and state regulation even to the extent of entrusting to state and national commissions the control of the rates charged and the service rendered.

Other questions, however, await solution, but can only be touched on here. Of these questions, those which are of greatest present-day interest are:

1. The adjustment of railroad rates.
2. The problem of wasted railroad tracks and branches.
3. The limits within which great railroad mergers are de-

sirable, and beyond which they become monopolistic.

4. The wisdom, feasibility, practicability, and necessity of government ownership of the railroads.

Problem of Rate Adjustment

1. There is one phase of the problem of rate regulation upon which the history of the Union Pacific bears directly, namely, the relation between rates and the return realized by the security-holder. It is frequently asserted that railroad rates should be maintained at a certain level, or raised, in order that the stockholders and bondholders may receive a reasonable return upon the capital invested. Statistics have been published in commercial journals, showing apparently that railroads pay relatively low dividends, and that many roads pay no dividends at all. The argument is then made that it cannot be said that a schedule of rates is unreasonable which is barely sufficient to maintain some railroads, and which permits dividends only in the case of comparatively few companies. Yet, in nearly every instance original railroad stocks were issued without consideration. Railroads have been overbonded, and the tendency toward inflation of a railroad's securities does not end with the road's construction. How the Union Pacific was overcapitalized from the start, and how its capitalization was later swelled during the Gould management, has been pointed out in previous chapters.¹ From the example of the Union Pacific it is seen that the amount of a road's capitalization is no indication of the amount of capital actually invested in the road; and a return which is small measured by the total amount of stock and bonds outstanding may yet be large when measured by the amount of capital actually invested, or when measured by the road's physical value. On the part of the government, the position is now taken that the fairest basis

¹ The Union Pacific is not at the present time overcapitalized. Owing to a great unearned increment, the right of way, lands, and terminal facilities of the Union Pacific are of great value, and many millions of dollars have been expended in permanent improvements upon the property and paid out of earnings. There is, however, widespread opinion that many of our railroads are largely overcapitalized.

upon which to predetermine a schedule of railroad tariffs is physical valuation and not the amount of securities outstanding.

Just as it by no means follows that because a railroad finds difficulty in paying interest or dividends, its rates are too low, so it does not necessarily follow that, because a railroad is able to pay a comparatively large dividend, its rates are unreasonably high. It is commonly assumed by many persons that, if the dividend rate of a railroad exceeds 6 or 7 per cent, the rates charged by that road are excessive. At one time James J. Hill said to the Interstate Commerce Commission in regard to the earnings of his company, the Great Northern, "You gentlemen would feel that you had a right to confiscate a part of it, if not the whole, if we exceeded 7 per cent." This has been the general attitude in regard to railroad dividends. This prevailing opinion that a high rate of dividend is an indication that a railroad's rates are excessive brought about at one time legislation which aimed to compel lower charges by restricting the rate of dividend. This character of legislation, both in England and America, tended to bring about inflation of railroad stocks. A dividend of 6 per cent per annum may be excessive or unwarranted, as in the case of the old Union Pacific Railroad in the last half of the decade from 1870 to 1880. On the other hand, a dividend of 10 per cent, in the case of a moderately capitalized and effectively and conservatively managed road, may not be excessive, and may not necessarily imply an excessive schedule of rates. This is a consideration often forgotten. Arbitrary limitation of return on capital invested is generally economically unsound; and its effect is either to discourage initiative or to encourage devices for evasion of the restraint imposed. No single criterion can safely be applied. Many elements must be considered in determining whether or not a given rate is reasonable, such as the cost of reproduction, the volume of

² *Northern Securities Company investigation* is 1902. In the matter of valuation, etc., p. 32.

traffic, capital actually invested, difficulties or expense of operation, amount of earnings put into improvements.

So long as railroads are privately owned, prudent and skilful management should be permitted to reap the reward of its management. Arbitrary restriction of income should not be made.³ It is moreover proper that a policy or rule favoring a fair degree of stability, and preventing frequent or easy changes in rates, should be earnestly supported, and enforced. Such policy is not alone likely to promote prudent management and the best class of service, but also to secure that degree of stability in relation to transportation rates which is so fundamentally necessary to successful business operations.

Watered Stocks and Bonds

2. One of the chief difficulties with the railroad question in the United States lies in the problem of watered stock and bonds. The inflation of railroad securities is well illustrated by the history of the Union Pacific. Railroads have been too often controlled and managed not as agents of transportation engaged in the legitimate business of carrying passengers and freight from one locality to another, and thus meeting their true function, public service, but as instruments for speculation. Besides placing a heavy burden upon the public, the operations of stock manipulators have frequently resulted in driving railroads into bankruptcy, and in inflicting great hardships upon persons who in good faith have invested in inflated railroad securities. The comparatively recent Rock Island investigation has shown that many reprehensible methods are still employed. In the earlier period, among the more prominent of many examples of speculative railroad management

³ As has been suggested, it is open to serious question whether the arbitrary restrictions of the Esch-Cummins Law may not have a tendency to discourage real economy and efficient management since the return on capital invested is arbitrarily limited. Weak roads that have been mismanaged are benefited by the law, while strong, conservatively run roads may suffer and service is likely to deteriorate by reason of the fact that there is less incentive for individual initiative on the part of railroad executives.

for but a small fraction of the total traffic of either or both roads. It does not yet seem to be generally understood that the prevention of combination of competing lines and the maintenance of railroad competition are not at all likely, since the passage in 1906 of the amended Interstate Commerce Law, to have more than a slight influence upon railroad rates; nor would the regulation of railroad rates by competition be either wholesome or satisfactory. The experience of railroading in this country and in other countries has, so far as an economic problem can be established, demonstrated that competition is a most unsatisfactory means for rate regulation and is likely to lead to uncertainty, unreasonableness, and instability, rather than to certainty, reasonableness, and stability. The real dangers presented by the consolidation of competing lines do not lie in unreasonable or excessive rates, but lie, first, in the possible disregard by the combining companies of the service to which the public is entitled, and second, in the size of the combinations which would result if great competing railroads were permitted to combine at will.

Proposed Government Ownership

4. The question of the wisdom, feasibility, practicability, and necessity of government ownership assumed great importance during and after the recent war with Germany. This question of government ownership is only suggested here as one meriting earnest consideration. The magnitude of our railroad system, broadly stated, appears from the following: The special report of the census office on Wealth, Debt and Taxation, published in 1907, placed the total aggregate wealth of the country at \$107,104,192,410; of this amount farm lands and improvements comprise \$16,614,647,491; land and buildings of manufactures, mines and quarries, and other business property comprise \$9,843,992,625; and railroads and equipment, \$11,244,752,000; giving to railroads about 10 per cent of our total national wealth. The volume of the railroad busi-

ness has grown to huge proportions. Our system of railroads was not developed under any definite plan, but has grown from the first few unimportant roads, by addition of new roads, from time to time. The policy of the United States has been to entrust the ownership and operation of these roads to private individuals.

There are admittedly weaknesses, in the private ownership and operation of this vast and intricate network of transportation lines. It is true that competition, so far as competition is possible, between independent companies is not effective as a rate regulator, and is a danger to legitimate investments in railroads. It is also true that railroads are natural monopolies. Many former advocates of government regulation, control, and supervision have expressed great disappointment at the apparent failure of this method of reaching the root of the railroad problem. Railroads are so organized that their stocks and the immense properties these stocks represent may be acquired through manipulation of the stock markets. It is also true that railroad corporations have been able to wield great power in matters pertaining to legislation and government. It is true too, that under government ownership, whatever profits might result would be the property of the government and not of individuals; and that whatever losses might be sustained would be sustained by the government instead of by individuals.

Due to considerations like these, there was during the years before the war a growing tendency on the part of the public to consider more seriously the possible advantages of government ownership of railroads. Since our government has grown from the earliest settlements and colonial form of government to its present size, largely apart from European and Asiatic institutions and government, we have no example in foreign governments that we can safely take as a guide in the question as to whether or not we should have government ownership of railroads. There is not a single foreign nation to whose form of government, owing to the great difference in character of

people, citizenship, and institutions, our form of constitutional government, developed under a progressive westward expansion from the Atlantic Coast to the Pacific, can be likened, so that the success or failure of government ownership of railroads in any one foreign country would be of little value to us in the same question here.

At the present time the United States government is operating the Panama Railroad. A government-owned railroad is also operating in Alaska. The conditions in the United States proper are very different, however, from the conditions in Panama or in Alaska. As is generally known, the government took over and operated the country's railroads during the recent war.

Although the experiment was made under war conditions, a general dissatisfaction with the manner in which the roads were operated developed. The danger of political control, and other serious drawbacks to government ownership have led to a general sentiment in favor of the continuance of the policy of private ownership. It would be beyond the scope of this work to discuss this problem, except merely to refer to it.

The most recent attempted solution of the problem was made in the early part of the year 1920, when Congress passed the Esch-Cummins Law, handing the railroads back to their owners, under, however, certain restrictions. The operation of this law, and its effect on the railroads of the country must be left to future determination.

APPENDIX

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